1933

Aug. 2—Hearing set in Long Beach, California, beginning Sept. 11, 1933.

Sept. 18—Hearing had before Mr. Marquette on merits. Submitted. Dockets 54773 and 60157 consolidated for hearing and decision. Stipulation of facts. Briefs due Nov. 22, 1933. Called Sept. 11, 1933.

Nov. 10—Motion for extension of 30 days to file brief filed by taxpayer.

Nov. 13—Motion for extension of 30 days to file brief granted to Dec. 22, 1933 as to both parties.

Nov. 22—Brief filed by General Counsel.

Dec. 15—Motion for extension of 30 days to file brief filed by taxpayer.

Dec. 15—Motion for extension of 30 days to file brief granted to Jan. 22, 1934 to both parties.

1934

Jan. 20—Supplemental brief filed by General Counsel.

Jan. 22—Motion for extension of 30 days to file brief filed by taxpayer. 1-23-34 granted to 2-21-34.

Jan. 30—Stipulation of facts filed.

Feb. 19—Brief filed by taxpayer.

1936

Apr. 14—Opinion rendered, John A. Tyson, Div. 1. Decision will be entered under Rule 50.

1936

May 6—Notice of settlement filed by General Counsel.

May 9—Hearing set May 27, 1936 on settlement. [1*]

May 27—Hearing had before Mr. Sternhagen on settlement under Rule 50. Respondent's recomputation—not contested—Referred to Mr. Tyson for decision.

May 28—Decision entered—John A. Tyson, Div. 1.

May 28—Consent to settlement filed by taxpayer.

June 2—Order vacating decision, entered.

June 2—Decision entered—John A. Tyson, Div. 1.

Aug. 25—Notice of the appearance of George T. Altman counsel for taxpayer.

Aug. 27—Petition for review by United States Circuit Court of Appeals, Ninth Circuit, with assignments of error filed by taxpayer.

Aug. 27—Proof of service filed by taxpayer.

Oct. 2—Praecipe filed.

Oct. 2—Proof of service of praecipe filed. [2]

*Page numbering appearing at the foot of page of original certified Transcript of Record.

APPEARANCES:

For Taxpayer:

W. L. E. O'BRYAN, Esq.,
GEORGE T. ALTMAN,
FRED R. ANGEVINE, Esq.,
C. WM. WITTMAN, Esq.

For Comm'r:

ELDEN McFARLAND, Esq.,
JOHN F. GREANEY, Esq.,
E. G. SIEVERS, Esq.

Docket No. 60157.

ELBE OIL LAND DEVELOPMENT COMPANY,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DOCKET ENTRIES.

1931

Oct. 9—Petition received and filed. Taxpayer notified. (Fee paid).

Oct. 12—Copy of petition served on General Counsel.

Nov. 27—Answer filed by General Counsel.

Dec. 2—Copy of answer served on taxpayer. Circuit Calendar.

1933

Aug. 2—Hearing set for week of Sept. 11, 1933, Long Beach, California.,

Sept.18—Hearing had before Mr. Marquette, Div. 1, on merits, Consol. with 54773. Briefs due Nov. 22, 1933. Called Sept. 11, 1933.

Nov. 10—Motion for 30 days additional to file briefs filed by taxpayer.

Nov. 13—Motion granted to Dec. 22, 1933 both parties.

Nov. 22—Brief filed by General Counsel.

Dec. 15—Motion for 30 days extension to file brief, filed by petitioner. 12/15/33 granted to Jan. 22, 1933 both parties.

1934

Jan. 20—Supplemental brief filed by General Counsel.

Jan. 22—Motion for 30 days extension to file brief filed by petitioner. 1/23/34 granted to 2/21/34.

1936

Apr. 14—Opinion rendered, Mr. Tyson, Div. 1. Decision will be entered under Rule 50.

May 6—Notice of settlement filed by General Counsel.

May 9—Hearing set May 27, 1936 on settlement.

May 28—Consent to settlement filed by taxpayer.

May 27—Hearing had before Mr. Sternhagen on Settlement under Rule 50. Respondent's Recomputation—not contested—Referred to Mr. Tyson for decision.

May 28—Decision entered, John A. Tyson, Div. 1.

1936

June 2—Order vacating decision entered.

June 2—Decision entered, Mr. Tyson, Div. 1.

Aug. 25—Notice of the appearance of George T. Altman filed.

Aug. 27—Petition for review by United States Circuit Court of Appeals, Ninth Circuit, with assignments of error filed by taxpayer.

Aug. 27—Proof of service filed by taxpayer.

Oct. 2—Praecipe filed.

Oct. 2—Proof of service filed. [4]

United States Board of Tax Appeals

Docket No. 54773

ELBE OIL LAND DEVELOPMENT COMPANY,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION

The above named corporation hereby appeals from the determination of the Commissioner of Internal Revenue set forth in his letter (IT:AR:E-3 TCC-60D) dated February 26, 1931, and as the basis of its appeal sets forth the following:

1. The petitioner is the Elbe Oil Land Development Company, a California corporation, whose

business address is 714 West Tenth Street, Los Angeles, California.

2. The deficiency letter, a copy of which is attached, was mailed to the petitioner on February 26, 1931 and states an alleged liability of $16,626.09.

3. The taxes in controversy are income taxes for the calendar year 1928, and are in the amount of $16,626.09. There is no tax for the calendar year 1927, the income of which is also involved.

4. The determination of tax set forth in said notice of deficiency is based upon the following errors:

(a) The respondent erred in holding the October 3, 1927 agreement with the Honolulu Consolidated Oil Company to have been a sale and not a sublease and in failing to allow the petitioner depletion on bonuses and royalties received under the terms of the agreement. [5]

(b) The respondent erred in holding that certain reimbursements for purchase of materials and supplies were income to the petitioner.

(c) The respondent erred in failing to allow as deductions from income in 1927 and 1928 certain amounts paid for traveling and other business expenses.

(d) The respondent erred in failing to allow as deductions from income in 1928 certain insurance and automobile expense.

(e) The respondent erred in failing to allow as deduction in 1928 depreciation on automobile used for business purposes.

(f) The respondent erred in failing to allow as deduction from income in 1927, depreciation on office furniture and fixtures, automobiles, and other tools and equipment owned and used by petitioner.

(g) The respondent erred in failing to recognize that the assessment and/or collection of the said alleged deficiency is barred by the relevant provisions of the Statutes of Limitation.

5. The facts upon which the petitioner relies as the basis of this proceeding are as follows:

(a) The petitioner, by reason of an agreement with the Honolulu Consolidated Oil Company, dated October 3, 1927, was the owner of a sub-lease on certain properties and by reason of this sub-lease received certain amounts in 1927 and 1928 as bonuses or royalties. These amounts are subject to depletion allowances as provided in Section 214 (a) (9) of the Revenue Act of 1926 and Sections 114 (a) (3) and Section 23 (a) of the Revenue Act of 1928.

(b) An amount of $5,178.65 was expended by the petitioner for material and supplies subsequent to October 3, 1927 on properties operated by the Honolulu Consolidated Oil Company under agreement of October 3, 1927. This amount was later reimbursed to the petitioner by the Honolulu Consolidated Oil Company. This amount is not income but should be eliminated from the cost of properties.

(c) The petitioner during the year 1927 reimbursed L. S. Barnes, its chief executive officer, for traveling expenses incurred on its behalf in [6] the amount of $14,678.51 of which the respondent has allowed only $1,578.51 as a deduction from income. In 1928 traveling expense reimbursements amounted to $5,202.56 of which the respondent was allowed only $638.05 as a deduction from income. The amounts reimbursed were legitimate expenses necessary to carry on the petitioner's business and should be allowed.

(d) The petitioner expended during the year 1928, the sum of $4,136.22 for insurance and automobile expenses. The respondent has allowed of this amount only $2,791.03 as a deduction against income. The entire amount should be allowed as they were incurred entirely in the petitioner's business.

(e) The petitioner on March 1, 1928 purchased a Lincoln automobile for $5,451.00. Depreciation for nine months at rate of 25% per annum amounted to $1,022.04.

(f) The petitioner in its income tax return for the calendar year 1927 failed to deduct depreciation on certain assets owned. Depreciation is now claimed on these assets as follows:

Asset	Cost	Rate	Depreciation
Automobiles	$3,147.40	25%	$ 786.85
Office Furniture, and Fixtures	2,600.73	10%	260.07
Machinery and Tools	4,054.50	10%	405.45
Total			$1,452.37

(g) The return of the petitioner was duly filed on May 15, 1929.

WHEREFORE, the petitioner prays that this Board may hear this proceeding and rule:

(a) That the petitioner is entitled to depletion on amounts received during the year 1928 by reason of the agreement with the Honolulu Consolidated Oil Company, dated October 3, 1927.

(b) That the amount of $5,178.65 reimbursed by the Honolulu Consolidated Oil Company is not income.

(c) That additional traveling expenses are allowable and deductible as follows: for the year 1927, $13,100.00; for the year 1928, $4,564.15. [7]

(d) That additional insurance and automobile expense of $1,345.19 is allowable and deductible for the year 1928.

(e) That additional depreciation on Lincoln Automobile purchased March 1, 1928 of $1,022.04 is allowable and deductible for the year 1928.

(f) That additional depreciation for the year 1927 in the amount of $1,452.37 is allowable and deductible.

(g) That the assessment and/or collection of any deficiency is barred by the Statutes of Limitation.

W. L. E. O'BRYAN,
Counsel for Taxpayer,
707 South Hill Street,
Los Angeles, California. [8]

State of California,
County of Los Angeles—ss:

L. S. Barnes, being duly sworn, deposes and says: that he is the Secretary and Treasurer of the Elbe Oil Land Development Company, the petitioner named in the foregoing petition, and as such is duly authorized to and does verify the foregoing petition; that he is familiar with the statements contained therein and that the facts stated are true and correct to the best of his knowledge and belief.

L. S. BARNES.

Sworn to before me this 20th day of March, 1931.
[Seal] (Signed) IRMA E. COMSTOCK,
Notary Public. My commission expires Nov. 9, 1931.
[9]

NP-2-28

TREASURY DEPARTMENT
Washington

Office of
Commissioner of Internal Revenue

Feb. 26, 1931

Address Reply to
Commissioner of Internal Revenue
and refer to

Elbe Oil Land Development Company,
714 West Tenth Street,
Los Angeles, California.

Sirs:

You are advised that the determination of your tax liability for the year(s) 1928 discloses a deficiency of $16,626.09 as shown in the statement attached.

In accordance with section 272 of the Revenue Act of 1928, notice is hereby given of the deficiency mentioned. Within sixty days (not counting Sunday as the sixtieth day) from the date of the mailing of this letter, you may petition the United States Board of Tax Appeals for a redetermination of your tax liability.

HOWEVER, IF YOU DO NOT DESIRE TO PETITION, you are requested to execute the enclosed agreement form and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7. The signing of this agreement will expedite the closing of your return(s) by permitting an early assessment of any deficiency and preventing the accumulation of

interest charges, since the interest period terminates thirty days after filing the enclosed agreement, or on the date assessment is made, whichever is earlier; WHEREAS IF NO AGREEMENT IS FILED, interest will accumulate to the date of assessment of the deficiency.

Respectfully,
DAVID BURNET,
Commissioner.
By (Signed) J. C. WILMER
Deputy Commissioner.

Enclosures:
Statement
Form 882
Form 870 [10]

STATEMENT

IT:AR:E-3
JCC-60D

In re: Elbe Oil Land Development Company,
714 West Tenth Street,
Los Angeles, California.

TAX LIABILITY.

Years	Corrected Tax Liability	Tax Previously Assessed	Deficiency
1927	None	None	None
1928	$40,724.67	$24,098.58	$16,626.09
Total	$40,724.67	$24,098.58	$16,626.09

Reference is made to the report of the internal revenue agent in charge, Los Angeles, California, a

copy of which was mailed to you July 5, 1929, also to your protest dated August 19, 1929.

Careful consideration has been accorded your protest in connection with the findings of the examining officer and the report on the conference with your representatives in the office of the agent in charge at Los Angeles, September 19, 1929.

On December 10, 1930 one of your representatives Mr. W. L. E. O'Bryan from the New York office of Mattison, Davey and Winters was granted a hearing in this office at which time the representative requested that a 60-day letter be issued. Since the hearing Mr. O'Bryan has submitted certain additional information which has been given careful consideration in connection with the revenue agent's report.

The issues raised in your protest are as follows:

1. Disallowance of depletion on oil and gas leases sold.

2. Disallowance of $5,178.65 representing the cost of material and supplies purchased and used in connection with leases sold to the Honolulu Consolidated Oil Company.

3. Disallowance of a portion of deduction claimed for traveling expenses.

4. Disallowance of one-half of automobile expense claimed.

5. Disallowance of expense for power consumed in 1926.

All issues raised have been given careful consideration and the decisions reached are set forth as follows:

1. An examination of the copy of contract of sale dated December 3, 1927, indicates that certain leases described and identified therein were sold, assigned, transferred and conveyed [11] to the Honolulu Consolidated Oil Company for a basic consideration of $2,000,000.00 to be paid as follows:

Date	Amount
Upon execution of contract	$350,000.00
March 14, 1928	400,000.00
March 14, 1929	400,000.00
March 14, 1920	400,000.00
March 14, 1921	450,000.00
Total	$2,000,000.00

Further provision is made in the contract for the payment of interest attaching to deferred payments due March 14, 1930 and March 14, 1931.

In section 8 of the contract it is provided that from and after the time when the Honolulu Consolidated Oil Company (the purchaser) shall have been fully reimbursed for all expenditures made in the acquisition, development and operation of the properties made the subject of this agreement, the above-named purchaser shall pay to the taxpayer, on the twenty-fifth day of each month 33 1/3% of the net profit resulting from production and operation of said properties during the preceding calendar month.

The consideration of $2,000,000.00 is definite as to amount and periods of payment and it was the entire known consideration when the contract was

executed. The possibility of the taxpayer sharing in the net profits from the operation of the properties conveyed was contingent upon profits being earned great enough to extinguish the full costs of acquisition and development. A careful examination of the contract fails to disclose any reference to the contemplated payment of royalties in any manner, but instead discloses that full title and control passed to the purchaser for a fixed consideration.

In the computation of profit resulting from the sale of these leaseholds the recovery of the entire cost thereof has been allowed during the year of sale, 1927.

In this connection attention is invited to Exhibit A of the report of the agent in charge.

It is held that the payments made during 1927 and 1928, in accordance with the terms of the contract, represent a part of the consideration for the conveyance of the properties transferred [12] and not bonuses or advanced royalty payments subject to depletion as contemplated in article 216, Regulations 69 and article 236, Regulations 74.

2. With reference to the second issue the information at hand discloses that subsequent to October 3, 1927, the taxpayer purchased material and supplies for the account of Honolulu Consolidated Oil Company in the amount of $5,178.65 and charged this amount to the cost of property sold. When payment for these purchases was received surplus account was credited.

In view of the fact that purchaser was obligated by contract to reimburse the taxpayer for all material and supplies purchased after the effective date of the contract, October 3, 1927, it is held that these purchases do not represent a part of the cost of goods sold.

Upon receipt of payment the material and supply account should have been credited. The action of the examining officer in adjusting the net loss for 1927 in this manner is approved. Articles 22, 23 and 101, Regulations 69.

3. The information submitted indicates that traveling expenses claimed were overstated for 1927 and were not substantiated by the books and records submitted for examination. This deduction has been adjusted under the provisions of articles 22, 23 and 101, Regulations 69.

4. Automobile expense claimed for the year 1928 has been allowed in part as shown in the following statement. Items included in this deduction not substantiated by the books and records as the corporation's business expenses have been eliminated. Articles 321, 322 and 121, Regulations 74.

5. The deduction claimed in 1928 for power consumed in 1926 is not allowable. The expenses of one year cannot be used to reduce or offset the income of another. In this connection attention is invited to article 342, Regulations 74. An examination of the facts with respect to this deduction discloses that the taxpayer received full credit for deposits made for electric current in 1926 and that the full amount of payments made therefor repre-

sented expenditures affecting the net income for 1926. Articles 101 and 112, Regulations 69. [13]

A copy of this letter has been furnished your authorized representative, Mr. W. L. E. O'Bryan, c/o Mattison, Davey and Winters, 918 Chrysler Building, 405 Lexington Avenue, New York, New York.

1927.

NET INCOME.

Net income reported		($948.27)
Add:		
1. Additional profit on sale of leaseholds and equipment		28,285.44
		$27,337.17
Deduct:		
2. Additional depreciation	$ 100.00	
3. Additional current expenses	31,843.45	
4. Commissions	15,000.00	46,943.45
Net loss as adjusted		$19,606.28

EXPLANATION OF CHANGES

1. Profit on the sale of leaseholds has been computed under the provisions of articles 1561 and 1571, Regulations 69.

The computation in detail is shown in exhibit A of the revenue agent's report, a copy of which has been furnished you.

Cash received on sales contract in 1927	$350,000.00
Corrected cost of assets sold	238,269.98
Corrected profit realized in 1927	$111,730.02
Profit reported on the return	83,444.58
Additional profit	$28,285.44

2. Depreciation on two frame houses has been computed and allowed as follows:

Description	Cost	Rate Allowed	Depreciation
Frame house, lot No. 78-79	$1,500.00	4%	$60.00
Frame house, lot No. 80	1,000.00	4%	40.00
Total depreciation			$100.00
Brought forward			$100.00
Amount claimed			None
Additional depreciation allowed			$100.00

[14]

The above computation is made under the provisions of article 161, Regulations 69.

3. Rentals, interest and attorney's fees paid or accrued in 1927 are held to constitute deductible expenses for that year and have been eliminated from the cost of properties sold as referred to under explanation No. 1. Article 101, Regulations 69.

The items included in this amount are as follows:

Rentals	$16,160.00
Interest paid	3,754.94
Attorney's fees	10,350.00
Traveling expenses	1,578.51
Total	$31,843.45

Exhibit A attached to the internal revenue agent's report has been corrected with respect to the deduction claimed for traveling expenses which have been allowed to the extent of $1,578.51. The balance of the deduction claimed, $13,100.00 has not been substantiated by your books and records and has therefore been disallowed.

4. Additional commissions in connection with the sale of leaseholds in 1927, paid in 1928 are held to be allowable deductions for the former year. Article 112, Regulations 69.

COMPUTATION OF TAX.

Net loss as adjusted	$19,606.28
Tax assessable	None
Tax assessed	None
Deficiency or overassessment	None

1928.

NET INCOME.

Income reported		$200,821.52
		[15]
Brought forward		$200,821.52
Add:		
1. Previous years' expenses	$ 40,700.00	
2. Depletion disallowed	110,000.00	
3. Traveling expense disallowed	4,564.51	
4. Personal expenses and salary disallowed	2,992.54	158,257.05
Total		$359,078.57
Deduct:		
5. Additional depreciation	$ 100.00	
6. Adjusted net loss for 1927	19,606.28	19,706.28
Net income as adjusted		$339,372.29

EXPLANATION OF CHANGES.

1. Expenses applicable to prior years have been restored to taxable income.

a. Commissions allowed as deductions for 1927	$40,000.00
b. Deposit made in 1925 applied to payment of electric current consumed in that year	700.00
Total	$40,700.00

Commissions disallowed as a deduction for 1928 have been allowed under deductions numbers 3 and 4 for the year 1927. Article 342, Regulations 74.

Advance deposit made in 1925 by McKeon Drilling Company	$1,400.00
During the period from September 15, 1925 to December 9, 1925, the bills for current consumed amounted to	2,080.14
Balance paid by McKeon Drilling Company, January 19, 1926	$ 680.14

[16]

Since the taxpayer was billed for one-half of the current consumed and as these bills were paid in January 1926, it follows that this expense cannot attach to the production of income for 1928.

Amount deducted on return	$700.00
Amount disallowed	$700.00

2. Since the leaseholds formerly owned were sold, conveyed and transferred in 1927 without the retention of royalty rights, the provisions of article 221, Regulations 74 are not applicable and the deduction for depletion has been disallowed.

3. The deduction for traveling expenses, $4,564.51 has been disallowed. The books and records submitted for examination fail to substantiate

this amount as business expenses applicable to the production of the corporation's income for 1928. Articles 121 and 342, Regulations 74.

4. Personal expenses disallowed are computed as follows:

Automobile expense taken	$2,574.52
Insurance	1,561.70
Garage rent	180.00
Depreciation on Lincoln car	1,022.04
Depreciation on other cars	786.85
Total automobile expense claimed	$6,125.11
Excessive salary deduction for Mr. L. D. Barnes, Jr.,	793.96
Total deduction claimed	$6,919.07
Amount allowed	3,926.53
Personal expenses and salary disallowed	$2,992.54

The items constituting the amount disallowed are as follows:

Date	Description of Bill	Amount
May 1928	S. S. Nerney, Los Angeles (personal)	$ 6.50
August 1928	L. S. Barnes, Jr.	50.00
September 1928	Maddox, Inc., Lincoln car	124.50
September 1928	Beverly Hills Garage	24.87
November 1928	Shelton Garage, Beverly Hills, Gas and oil	49.38
November 1928	Beverly Hills Garage, Gas and oil	46.55
December 1928	Beverly Hills Garage, Gas and oil	13.08

[17]

Brought forward			$314.88
December 1928	Shelton Garage, Gas and oil		56.10
May 4, 1928	Southern California Auto Club, Lincoln insurance		163.05
August 11, 1928	Southern California Auto Club, Buick Sedan insurance		136.16
October 1928	New top for Pierce Arrow (from Saggor Mfg. Co.)		675.00
			$1,345.19
Depreciation claimed on automobiles		$1,808.89	
Cost of Pierce Arrow	$3,147.00		
New top in 1928	675.00		
Total cost	$3,822.00		
Depreciation at 25% allowed		955.50	
Depreciation on other cars disallowed			853.39
Portion of salary disallowed			793.96
Personal expenses and salary disallowed			$2,992.54

The expense items listed above appear to cover personal expenses of Mr. L. S. Barnes and family including depreciation on Lincoln and Buick cars kept at the home of Mr. Barnes for the use of his family. The cost of a new top for the Pierce Arrow car in 1928 has been treated as a capital expenditure and depreciation allowed thereon at the rate of 25%.

The salary adjustment is fully explained in schedule 3-A of the revenue agent's report.

This adjustment is made under the provisions of articles 121 and 323, Regulations 74.

5. Depreciation on frame buildings has been allowed on the same basis as for the year 1927. See

explanation of adjustment No. 2 of adjustments to net income for 1927 and article 201, Regulations 74.

6. The adjusted net loss for 1927 has been allowed as a deduction as provided in article 652, Regulations 74. [18]

COMPUTATION OF TAX

Net income as adjusted	$339,372.29
Income tax at 12%	$40,724.67
Tax previously assessed	24,098.58
Deficiency in tax	$16,626.09

[Endorsed]: Filed March 27, 1931. [19]

[Title of Court and Cause—Docket No. 54773.]

ANSWER

The Commissioner of Internal Revenue, by his attorney, C. M. Charest, General Counsel, Bureau of Internal Revenue, for answer to the petition of the above-named petitioner, admits and denies as follows:

1. Admits the allegations of paragraph 1.

2. Admits the allegations of paragraph 2.

3. Admits that the taxes in controversy are income taxes for the calendar year 1928 but denies that the amount in controversy is $16,626.09 as alleged in paragraph 3.

4. Denies that the Commissioner erred as alleged in paragraph 4 and its subdivisions.

5. Denies each and every allegation of paragraph 5 and its subdivisions which is inconsistent with or

contrary to the determination of the Commissioner as set forth in the deficiency notice.

6. Denies, generally and specifically, each and every allegation of the petition not hereinbefore admitted, qualified or denied.

WHEREFORE, it is prayed that the appeal be denied.

C. M. CHAREST,
General Counsel,
Bureau of Internal Revenue.

Of Counsel:
ELDEN McFARLAND,
ARTHUR CLARK,
Special Attorneys,
Bureau of Internal Revenue.

[Endorsed]: Filed Apr. 28, 1931. [20]

[Title of Court and Cause—Docket No. 60157.]

PETITION

The above named corporation hereby appeals from the determination of the Commissioner of Internal Revenue set forth in his letter (IT:AR:E-6 EIM-60D), dated September 8, 1931, and as the basis of its appeal sets forth the following:

1. The petitioner is the Elbe Oil Land Development Company, a California corporation, whose business address is 714 West Tenth Street, Los Angeles, California.

2. The deficiency letter, a copy of which is attached, was mailed to the petitioner on September 8, 1931 and states an alleged liability of $12,149.50.

3. The taxes in controversy are income taxes for the calendar year 1929, and are in the amount of $12,149.50.

4. The determination of tax set forth in said notice of deficiency is based upon the following errors:

(a) The respondent erred in holding the October 3, 1927 agreement with the Honolulu Consolidated Oil Company to have been a sale and not a sublease and in failing to allow the petitioner depletion on bonuses and royalties received under the terms of the agreement.

(b) The respondent erred in failing to allow as deductions, business expense in the amount of $550.00.

(c) The respondent has erred in calculations of income and the tax based thereon. [21]

5. The facts upon which the petitioner relies as the basis of this proceeding are as follows:

(a) The petitioner, by reason of an agreement with the Honolulu Consolidated Oil Company, dated October 3, 1927, was the owner of a sublease on certain properties and by reason of this sublease received certain amounts in 1929 as bonuses or royalties. These amounts are subject to depletion allowances as provided in Section 114 (a) (3) and Section 23 (a) of the Revenue Act of 1928.

(b) The petitioner, during the year 1929 paid to the Jonathan Club the amount of $550.00, which amount was paid for and as a business expense.

(c) The petitioner calls attention to the mathematical error in the respondent's income figures of $70.00. The respondent's income figures showing $304,382.16 whereas the correct figures, using respondent's adjustments to which the petitioner is taking exception, is $304,312.16.

WHEREFORE, the petitioner prays that this Board may hear this proceeding and rule:

(a) That the petitioner is entitled to depletion on amounts received during the year 1929 by reason of the agreement with the Honolulu Consolidated Oil Company, dated October 3, 1927.

(b) That the amount of $550.00 paid to the Jonathan Club is deductible as a business expense.

(c) That there is a mathematical error in the respondent's computation of the income shown in his letter of September 8, 1931.

W. L. E. O'BRYAN,
Counsel for Taxpayer,
707 South Hill Street,
Los Angeles, California. [22]

State of California,
County of Los Angeles—ss:

L. S. Barnes, being duly sworn, deposes and says: that he is the Secretary and Treasurer of the Elbe Oil Land Development Company, the petitioner named in the foregoing petition, and as such is duly authorized to and does verify the foregoing petition; that he is familiar with the statements contained therein and that the facts stated are true and correct to the best of his knowledge and belief.

L. S. BARNES.

Subscribed and sworn to before me this 2nd day of October, 1931.

[Seal] MAI FIELD DOUGLAS,
Notary Public. My Commission Expires December 14, 1933. [23]

TREASURY DEPARTMENT
Washington

Office of
Commissioner of Internal Revenue
Address reply to
Commissioner of Internal Revenue
and refer to

Sept. 8, 1931

Elbe Oil Land Development Company,
702 Petroleum Securities Building,
Los Angeles, California.

Sirs:

You are advised that the determination of your tax liability for the year 1929 discloses a deficiency of $12,149.50, as shown in the statement attached.

In accordance with section 272 of the Revenue Act of 1928, notice is hereby given of the deficiency mentioned. Within sixty days (not counting Sunday as the sixtieth day) from the date of the mailing of this letter, you may petition he United States Board of Tax Appeals for a redetermination of your tax liability.

HOWEVER, IF YOU DO NOT DESIRE TO PETITION, you are requested to execute the enclosed agreement form and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7. The signing of this agreement will expedite the closing of your return by permitting an early assessment of any deficiency and preventing the accumulation of interest charges, since the interest period terminates thirty days after filing the enclosed agreement, or on the date assessment is made, whichever is earlier; WHEREAS IF NO AGREEMENT IS FILED, interest will accumulate to the date of assessment of the deficiency.

Respectfully,
DAVID BURNET,
Commissioner.
By (Signed) J. C. WILMER
Deputy Commissioner.

Enclosures:
Statement
Form 882
Form 870 [24]

STATEMENT

IT:AR:E-6
EIM-60D

In re: Elbe Oil Land Development Company,
702 Petroleum Securities Building,
Los Angeles, California.

Tax Liability.

Year—1929.
Tax Liability—$33,474.34.
Previously Assessed—$21,324.84.
Deficiency—$12,149.50.

The report of the internal revenue agent at Los Angeles, California, covering an investigation of your books of account and record for the year 1929, has been reviewed and approved by this office.

A computation of your taxable net income is as follows:

1929.		
Net income reported on return		$193,862.16
Add: 1. Depletion	$110,000.00	
2. Initiation fee	550.00	110,550.00
		$304,382.16
Deduct: 3. Depreciation		100.00
Net income adjusted		$304,382.16

EXPLANATION OF CHANGES

1. Depletion of 27½% on $400,000.00 claimed on your return has been disallowed since the leaseholds formerly owned were sold in the year 1927 without the retention of royalty rights, therefore,

the provisions of article 221, Regulations 74 are not applicable.

It appears that during 1927 certain leases owned by the corporation were sold to the Honolulu Consolidated Oil Company for a consideration of $2,000,000.00 to be paid as follows:

Date	Amount
Upon execution of contract	$350,000.00
March 14, 1928	400,000.00
March 14, 1929	400,000.00
March 14, 1930	400,000.00
March 14, 1931	450,000.00
Total	$2,000,000.00

[25]

It is held that the payment received during the year 1929, in accordance with the terms of the contract of sale represent a part of the consideration for the conveyance of the properties transferred, and not advanced royalties subject to depletion allowance as contemplated in article 236, Regulations 74.

In General Counsel Memorandum 1023, Cumulative Bulletin VI-1, page 19, it is held that income arising from the sale of oil and gas property or any interest therein may not be taken into consideration in computing the allowance for depletion. To the same effect see case of Darly-Lynde Co. v. Acel C. Alexander, Collector of Internal Revenue, Ct. D. 245, Cumulative Bulletin IX-2, page 176.

2. This item represents certain fee paid to the Jonathan Club which is disallowed as an ordinary and necessary expense.

3. Additional depreciation has been allowed on fixed assets computed as follows:

Asset	Cost	Rate	Allowance
Dwelling	$2,500.00	4%	$100.00
Depreciation claimed			none
Depreciation allowed			$100.00

COMPUTATION OF TAX.

Net income adjusted	$304,382.16
Income tax at 11%	33,474.34
Tax previously assessed, Account #402627	21,324.84
Deficiency	$ 12,149.50

Since the prior year 1928 is now before the United States Board of Tax Appeals, and the same issue is involved for the year 1929 a final letter of determination is being issued in accordance with section 272 of the Revenue Act of 1928.

[Endorsed]: Filed Oct. 9, 1931. [26]

[Title of Court and Cause—Docket No. 60157.]

ANSWER

The Commissioner of Internal Revenue, by his attorney, C. M. Charest, General Counsel, Bureau of Internal Revenue, for answer to the petition of the above-named petitioner, admits and denies as follows:

1. Admits the allegations of paragraph 1.

2. Admits the allegations of paragraph 2.

3. Admits that the taxes in controversy are income taxes for the calendar year 1929, but denies that the amount in controversy is $12,149.50 as alleged in paragraph 3.

4. Denies that the Commissioner erred as alleged in paragraph 4 and its subdivisions.

5. Denies each and every allegation of paragraph 5 and its subdivisions which is inconsistent with or contrary to the determination of the Commissioner as set forth in the deficiency notice.

6. Denies, generally and specifically, each and every allegation of the petition not hereinbefore admitted, qualified or denied.

WHEREFORE, it is prayed that the Board redetermine the amount of the deficiency involved in this proceeding to be equal to the amount determined by the Commissioner plus any additional amount which may arise from the correction of any error or errors that may have been committed by the Commissioner. Claim is hereby asserted for the increased deficiency, if any, resulting from such redetermination.

(Signed) C. M. CHAREST,
General Counsel,
Bureau of Internal Revenue.

Of Counsel:
ELDEN McFARLAND,
ARTHUR CLARK,
Special Attorneys,
Bureau of Internal Revenue.

[Endorsed]: Filed Nov. 27, 1931. [27]

[Title of Court and Cause—Docket Nos. 54773, 60157.]

STIPULATION OF FACTS.

It is stipulated by and between the above-named parties by their respective counsel, that the following facts may be taken as true subject to the right of either party to submit further and additional facts not in conflict therewith.

1. Petitioner is a corporation organized February 4, 1925, under the laws of the State of California. It acquired certain properties consisting of oil and gas prospecting permits, drilling agreements, leases and drilling and producing equipment. It carried on a substantial amount of development work resulting in the discovery of oil and on October 3, 1927, oil was being produced in commercial quantities.

As of October 3, 1927, petitioner entered into an agreement with Honolulu Consolidated Oil Company, a California corporation. A copy of the agreement is attached hereto and marked Exhibit A. Pursuant to the terms of the agreement, petitioner transferred its assets to Honolulu Consolidated Oil Company, and it received the following sums of money at the times stated, to-wit:— [28]

Upon execution of contract, (November 1927)	$ 350,000.00
March 14, 1928,	400,000.00
March 14, 1929,	400,000.00
March 14, 1930,	400,000.00
March 14, 1931,	450,000.00
Total	$2,000,000.00

That of the $2,000,000, to be received by the petitioner in cash and notes, $1,963,672.95 was consideration for the oil and gas rights in the leases and the remainder was consideration for equipment and other property.

Up to the present time no repayments have become due or have been paid under the provisions of paragraph 8 of said agreement providing for the payment to petitioner of 33 1/3% of the net profits resulting from the operation of the properties under the conditions set forth.

The total cost of all assets transferred pursuant to said agreement was less than the amount of $350,000.00 received in 1927. In its income tax return for that year the petitioner reported a taxable gain of $83,444.58 by applying the entire basis against $350,000.00. It reported losses from operations sufficient to indicate a net loss of $948.27. Upon investigation, the Revenue Agent increased the gain on sale of $28,285.44 but increased deductions to the extent that a net loss of $18,027.77 was indicated. This net loss was increased by the income tax unit to $19,606.28 and was applied in the deficiency notice, as a deduction for 1928.

In filing its income tax return for 1928, the petitioner submitted a statement indicating that by the agreement dated October 3, 1927, it in effect subleased its properties and that the payments received by it were bonuses or advance royalties. The amount of $400,000.00 was returned as gross income as "bonus on sublease." A deduction of $110,000.00

was claimed for depletion representing 27½ per cent of $400,000.00. In its income [29] tax return for the year 1929, petitioner returned the amount of $400,000.00 as advance royalties and a similar deduction of $110,000.00 was claimed for depletion.

The Bureau disallowed the depletion deductions for both 1928 and 1929.

2. Petitioner waives the assignment of error set forth in Subdivision (b), Paragraph 4 of its petition in docket No. 54773.

3. The parties agree that the deductions claimed in Subdivision (c) of Paragraph 4 of the petition in Docket No. 54773, should be allowed to the extent of $11,775.03 for the year 1927, and $4,564.51 for the year 1928.

4. The parties agree that the deductions claimed in Subdivision (d) of Paragraph 4 of the petition in Docket No. 54773, should be allowed to the extent of $344.05.

5. The parties agree that the deduction claimed in Subdivision (e) of Paragraph 4 of the petition in Docket No. 54773, should be allowed to the extent of $1,022.04.

6. The parties agree that the deductions claimed in Subdivision (f) of Paragraph 4 of the petition in Docket No. 54773, should be allowed to the extent of $1,452.37.

7. Petitioner waives the issue of the Statute of Limitations set forth in Subdivision (g) of Paragraph 4 of the petition in Docket No. 54773.

8. Petitioner waives the issues set forth in Subdivisions (b) and (c) of Paragraph 4 of the petition in Docket No. 60157.

It is further stipulated that this case may be submitted upon [30] the pleadings and upon this stipulation of facts without the necessity of further appearance at the time set for hearing.

W. L. E. O'BRYAN
Attorney for Petitioner.

E. BARRETT PRETTYMAN
General Counsel, Bureau of Internal Revenue,
Attorney for Respondent. [31]

THIS AGREEMENT, made as of the 3rd day of October, 1927, by and between ELBE OIL LAND DEVELOPMENT COMPANY, a corporation organized and existing under and by virtue of the laws of the State of California, first party (hereinafter referred to as "ELBE"), and HONOLULU CONSOLIDATED OIL COMPANY, a like corporation, second party (hereinafter referred to as "HONOLULU"),

WITNESSETH:

WHEREAS, ELBE is the assignee and owner and holder of those certain United States Oil and Gas Prospecting Permits (hereinafter referred to as "Permits"), covering all of Section Eighteen (18), the north half and the southeast quarter of Section Twenty (20), and all of Section Twenty-eight (28), in Township Twenty-eight (28) South,

Range Twenty-nine (29) East, Mount Diablo Base and Meridian, Kern County, California; and has made and entered into drilling agreements, dated April 7th, 1927, with B. M. Tibbet, Harriet E. Douglas, Harry Sheehan and Olive M. Davis (formerly Olive M. Lowry), hereinafter referred to as "Permittees of Section Eighteen (18), in respect to the drilling of oil and/or gas wells on said Section Eighteen (18); and has also made and entered into a drilling agreement with A. J. Matthews, dated October 15th, 1927, in respect to the drilling of oil and/or gas wells on the north half and the southeast quarter of said Section Twenty (20), and all of said Section Twenty-eight (28); and [32]

WHEREAS, ELBE is the lessee under oil and gas leases covering the southwest quarter of Section Twenty (20); all of Section Twenty-nine (29); Lots One (1), Two (2) and Three (3) and the east half of the northwest quarter and the northeast quarter of the southwest quarter of Section Thirty (30), and the northeast quarter of Section Thirty-one (31), Township Twenty-eight (28) South, Range Twenty-nine (29) East, Mount Diablo Base and Meridian, Kern County, California; and

WHEREAS, ELBE has heretofore agreed to sell and HONOLULU to purchase all of ELBE'S right, title and interest in and to said permits and drilling agreements and leases, upon the terms and conditions hereinafter set forth:

NOW, THEREFORE, in consideration of the mutual promises and covenants of the parties hereto, said parties do hereby agree as follows:

1. ELBE hereby grants, bargains, sells, assigns, transfers and conveys unto HONOLULU all of ELBE'S right, title and interest in and to the following described property, to-wit:

PARCEL ONE.

(a) Five United States Oil and Gas Prospecting Permits, issued pursuant to the Act of Congress approved February 25th, 1920, and entitled "An Act to Promote the Mining of Coal, Phosphate, Oil, Oil Shale, Gas and Sodium on the Public Domain," which said permits are particularly described as follows: [33]

(1) Sacramento No. 019845 (formerly Visalia No. 010682), issued to B. M. Tibbet and covering the northeast quarter of Section Eighteen (18), Township Twenty-eight (28) South, Range Twenty-nine (29) East, Mount Diablo Base and Meridian;

(2) Sacramento No. 019846 (formerly Visalia No. 010683), issued to Harriet E. Douglas and covering the northwest quarter of Section Eighteen (18), Township Twenty-eight (28) South Range Twenty-nine (29) East, Mount Diablo Base and Meridian;

(3) Sacramento No. 019847 (formerly Visalia No. 010684), issued to Harry Sheehan and covering the southwest quarter of Section Eighteen (18), Township Twenty-eight (28) South, Range Twenty-nine (29) East, Mount Diablo Base and Meridian;

(4) Sacramento No. 019848 (formerly Visalia No. 010685), issued to Olive M. Lowry and covering the southeast quarter of Section Eighteen (18), Township Twenty-eight (28) South, Range Twenty-nine (29) East, Mount Diablo Base and Meridian;

(5) Sacramento No. 019840 (formerly Visalia No. 010673), issued to A. J. Matthews and covering the north half and the southeast quarter of Section Twenty (20) and all of Section Twenty-eight (28), Township Twenty-eight (28) South, Range Twenty-nine (29) East, Mount Diablo Base and Meridian;

together with all right, title, interest, claim and demand of Elbe in and to the premises embraced within said permits, and in and to all wells drilled and completed and/or being drilled upon the premises covered by said permits.

(b) Five drilling agreements more particularly described as follows:

(1) Agreement dated April 7th, 1927, between L. S. Barnes and B. M. Tibbet in respect to drilling the lands covered by United States Gas and Oil Prospecting Permit, Sacramento No. 019845;

(2) Agreement dated April 7th, 1927, between L. S. Barnes and Harriet N. Douglas in respect to [34] drilling the lands covered by United States Gas and Oil Prospecting Permit, Sacramento No. 019846;

(3) Agreement dated April 7th, 1927, between L. S. Barnes and Harry Sheehan in respect to drilling the lands covered by United States Gas and Oil Prospecting Permit, Sacramento No. 019847;

(4) Agreement dated April 7th, 1927, between L. S. Barnes and Olive M. Lowry in respect to drilling the lands covered by United States Gas and Oil Prospecting Permit, Sacramento No. 019848;

(5) Agreement dated October 15th, 1927, between Elbe Oil Land Development Company and A. J. Matthews in respect to drilling the lands covered by United States Gas and Oil Prospecting Permit, Sacramento No. 019840.

and any and all agreements amendatory thereof or supplementary thereto.

PARCEL TWO.

Four leases more particularly described as follows:

(1) Oil and gas lease from W. D. Freeman and Clara B. Freeman, his wife, as lessors, to Elbe Oil Land Development Company, as lessee, dated June 18th, 1926, and covering the southwest quarter of said Section Twenty (20), Township Twenty-eight (28) South, Range Twenty-nine (29) East, Mount Diablo Base and Meridian.

(2) Oil and gas lease from Lucy Eleanor Jewett and S. Wright Jewett, her husband, as

lessors, to Elbe Oil Land Development Company, as lessee, dated April 9th, 1927, and covering the east half of Section Twenty-nine (29), Township Twenty-eight (28) South, Range Twenty-nine (29) East, Mount Diablo Base and Meridian;

(3) Oil and gas lease from Thomas N. Harbert and Phoebe A. Harbert, his wife, as lessors, to Elbe Oil Land Development Company, as lessee, dated February 10, 1927, and covering Lots One (1), Two (2) and Three (3) and the east half of the northwest quarter and the [35] northeast quarter of the southwest quarter of said Section Thirty (30), Township Twenty-eight (28) South, Range Twenty-nine (29) East, Mount Diablo Base and Meridian;

(4) Oil and Gas lease from Lucy Eleanor Jewett and S. Wright Jewett, her husband, as lessors, to Elbe Oil Land Development Company, as lessee, dated October 25th, 1926, and covering the west half of said Section Twenty-nine (29) and the northeast quarter of said Section Thirty-one (31), Township Twenty-eight (28) South, Range Twenty-nine (29) East, Mount Diablo Base and Meridian;

together with all right, title, interest, claim and demand of ELBE in and to the premises embraced within said leases, and in and to all wells drilled or completed and/or being drilled upon the premises covered by said leases.

PARCEL THREE.

All derricks, rigs, tools, appliances and all machinery, pipe and pipe lines and oil and/or water storage tanks and all other personal property now located upon any of the lands described in Parcels One and Two, except the tools and machinery now used in drilling Elbe Well No. 6, located on the southwest quarter of the said Section Twenty (20); provided, however, that HONOLULU, without charge, shall have the exclusive right to use said tools and machinery now used in drilling said Elbe Well No. 6 until said well is completed, at which time said tools and machinery shall be returned to ELBE, in the condition they are in at that time. [36]

PARCEL FOUR.

An agreement dated April 22nd, 1927, between Lucy Eleanor Jewett and her husband, S. Wright Jewett, as parties of the first part, and Elbe Oil Land Development Company, as party of the second part, in reference to the exclusive right, for a period of twenty years from said date, to use all water in that certain well situated on the northwest corner of Section Thirty-one (31), Township Twenty-eight (28) South, Range Twenty-nine (29) East, Mount Diablo Base and Meridian, together with all pumps, tools, machinery and appliances now used thereon or in connection therewith.

2. ELBE agrees to defend and hold HONOLULU harmless from any loss or liability whatsoever on account of any lien or encumbrance for work and/or labor done and/or materials furnished, at the request of ELBE, and used on the properties described in Parcels One, Two and Four above.

ELBE agrees to join in and make all necessary applications to the Department of Interior of the United States, for the purpose of securing the consent of the said Secretary of the Interior to the assignment of said permits to HONOLULU, and HONOLULU shall have the right, and is hereby authorized, to make all necessary and proper applications, in the name and in behalf of ELBE, for the purpose of securing any extensions or modifications of said permits, or any lease or leases granted pursuant thereto. [37]

ELBE warrants title to the personal property described in Parcel Three hereof, and that the same is free and clear of all claims, demands, liens and encumbrances; and ELBE agrees to defend and hold HONOLULU harmless from any and all claims, demands, losses and/or liabilities occasioned by any claim, demand, lien and/or encumbrance thereon.

3. Possession of the properties above described shall immediately vest in HONOLULU, and HONOLULU shall have full charge and control of all drilling and other work to be performed in connection with said permits and drilling agreements and leases and the lands covered thereby, and shall

have the sole ownership of and the right to sell or otherwise dispose of, all oil and/or gas and derivative products produced in, on or upon said properties. It is the intention of the parties to this agreement that the full and complete ownership, control and operation of said properties shall vest, upon execution hereof, in HONOLULU (Subject to the provisions of Paragraph 9), and ELBE shall have no interest in or to any of said properties whatsoever.

4. HONOLULU hereby assumes and agrees to perform each and every covenant on ELBE'S part to be performed under and by virtue of said drilling agreements, and to drill all wells and do and perform all work and labor required by the United States, in order to protect said permits, at the times and in the manner required by any law of the United States or rule or regulation of the proper governmental department thereof, or any amendment thereto or supplement or modification [38] thereof, provided, however, that in the event the Secretary of the Interior shall require all of said permits to be consolidated, along with any other permit or permits held by HONOLULU, in one permit, in the name of HONOLULU, as assignee, HONOLULU shall not be obligated to drill any more wells or do or perform any more work or labor than necessary to prevent default in said drilling agreements, and than may be required by any law of the United States or rule or regulation

of the proper governmental department thereof, in order to protect such consolidated permit.

HONOLULU shall have the right, and is hereby authorized, to negotiate with, and obtain from, the government of the United States and/or the original permittees, any modification and/or extension of the said permits and/or the said drilling agreements (hereinabove described in Parcel One). HONOLULU shall pay to ELBE any and all sums actually expended by ELBE in the operation and development of any or all of the properties, subject to this agreement, after October 3, 1927, and such further sum or sums as ELBE shall expend at the request of HONOLULU for the purpose of securing any modification and/or extension and/or consolidation of said permits and/or the said drilling agreements (hereinabove described in Parcel One).

5. HONOLULU hereby assumes and agrees to perform each and every covenant on ELBE'S part to be performed under and by virtue of said leases, and to drill all wells and do [39] and perform all work and labor required by the terms of said leases, in order to protect the same.

HONOLULU shall have the right, and is hereby authorized, to negotiate with, and obtain from the original lessors any modification and/or extension of the said leases (hereinabove described in Parcel Two), consulting only its own interest in respect thereto, and shall be entitled to all benefits derived therefrom.

5. HONOLULU shall pay to the government of the United States the royalty or royalties provided

by said permits, or any lease or leases issued by reason thereof, and as may be required pursuant to any law of the United States or rule or regulation of the proper governmental department thereof, and shall further pay to the original permittees, or their assignees of record, the royalty reserved to said permittees, or assignees of record, as their respective interests may appear, under and by virtue of the said drilling agreements, and shall further pay to the lessors of the lands covered by said leases the royalty reserved to the said lessors, as their respective interests may appear under and by virtue of the said leases.

7. HONOLULU shall pay to ELBE, upon the execution of this agreement and the approval by HONOLULU of ELBE'S title to all of said properties, the subject of this agreement, the sum of Three Hundred Fifty Thousand ($350,000.00) Dollars. ELBE hereby acknowledges that HONOLULU has heretofore advanced [40] to ELBE the sum of Fifty Thousand ($50,000.) Dollars, which said sum shall be credited as part payment of the said sum of Three Hundred Fifty Thousand ($350,000.) Dollars.

Thereafter, HONOLULU, if it shall not elect to abandon the purchase of said properties as provided by Paragraph 9 hereof, shall further pay to ELBE the sum of Four Hundred Thousand ($400,000.) Dollars on the 14th day of March, 1928, a like sum on the 14th day of March, 1929, a like sum on the 14th day of March, 1930, together with interest on

said last mentioned sum from March 14, 1929, until paid, at the rate of two and one-half (2½%) percent per annum, payable annually, and the further sum of Four Hundred and Fifty Thousand ($450,000.) Dollars on the 14th day of March, 1931, together with interest on said last mentioned sum from the 14th day of March, 1929, until paid, at the rate of two and one-half percent (2½%) per annum, payable annually.

8. From and after the time when HONOLULU shall have been fully reimbursed, in the manner and to the extent hereinafter provided, for all expenditures made in the acquisition, development and operation of the properties which are the subject of this agreement, HONOLULU shall pay to ELBE, on the twenty-fifth day of each and every month, thirty-three and one-third (33-1/3%) percent of the net profits (as such term is hereinafter defined) resulting from the production and operation of said properties during the preceding calendar month. [41]

The reimbursement of HONOLULU for all expenditures made and/or incurred in the acquisition, development and operation of said properties shall be computed at the time of the actual sale in the field of said oil and/or gas or derivative products, by valuing all of said oil and/or gas or derivative products produced in, on or upon and saved from the lands described in and covered by said United States Government Prospecting Permits, referred to in Parcel One above (exclusive of all royalties

paid to the United States and all royalties paid under and by virtue of said drilling agreements referred to in Parcel One (b) above), at seven and one-half (7½%) percent less than the current market price at the well for such oil and/or gas or derivative products, and by valuing all oil and/or gas or derivative products produced in, on or upon and saved from the lands described in and covered by said leases, referred to in Parcel Two above (exclusive of all royalties paid to the original lessors under and by virtue of said leases) at five (5%) percent less than the current market price at the well for such oil and/or gas or derivative products, and deducting therefrom the following items:

(a) All payments made by HONOLULU to ELBE in connection with the acquisition of said properties, including interest, as provided by Paragraph 7 hereof; and

(b) All expenditures made or incurred by HONOLULU in securing the consent of the Secretary of the [42] Interior to the assignment of said permits to HONOLULU, together with all costs of making or securing any lease or leases pursuant to said permits, or any modification or consolidation thereof, and/or in complying with any laws, rules or regulations of the United States, or the proper governmental department thereof, and/or in securing any assignments, extensions or modifications of said leases described in Parcel Two, including

any and all sums paid by HONOLULU to ELBE for the operation of the properties, the subject of this agreement, after October 3, 1927, and all sums paid by HONOLULU to ELBE for the purpose of securing any modifications and/or extension and/or consolidation of the said permits and/or the said drilling agreements;

(c) All expenditures made or incurred by HONOLULU in the acquisition and installation and maintenance of all machinery, tools and facilities necessary for the development and/or the operation of said properties, and for the production of oil and/or gas thereon, and for the manufacture of casinghead gasoline and/or other derivative products, including all expenditures incident to the development and operation of said properties and/or auxiliary to the said production of oil and/or gas or derivative products; and [43]

(d) The part or portion of the general administrative and overhead expense of HONOLULU in connection with the supervision or administration of all properties owned and/or controlled by HONOLULU, including the properties, the subject of this agreement, directly attributable to the acquisition and/or incident to the ownership, development and operation of the properties, the subject of this agreement.

HONOLULU shall be the sole judge of the character and necessity and extent of said expen-

ditures of acquisition, development and operation of said properties, as above defined, and may expend any and all sums which, in its judgment, may be reasonably necessary therefor; and the enumeration of particular items of expenditure hereinabove set forth shall not preclude or prevent HONOLULU from including in such expenditures any and all expenditures actually made or incurred by HONOLULU in the acquisition, development and operation of said properties.

In the event that the parties hereto shall disagree in reference to the propriety of any charge or charges made by HONOLULU in computing its reimbursement as above provided, the propriety of such charge or charges shall be conclusively determined by Mattison and Davey, certified public accountants of San Francisco, California. Upon thirty (30) days notice in writing given to HONOLULU by ELBE, ELBE shall [44] have the right, at the end of any calendar year after the year 1927, to designate a firm of certified public accountants of San Francisco, California, which shall be acceptable to HONOLULU, to determine the propriety of any charge or charges made by HONOLULU in computing its reimbursement as above provided, in lieu of said Mattison and Davey.

The term "market price" as used in this agreement shall mean the market price established by Standard Oil Company of California in the district wherein the said properties are located, for oil and/or gas or derivative products of like kind and

gravity; and in the event Standard Oil Company of California shall not establish any market price for the district wherein said properties are located, then the market price shall be the published field price for oil and/or gas or derivative products of like kind and gravity, in the nearest district.

The term "net profits" as used in this agreement shall be the profits resulting to HONOLULU from the production and operation of said properties, computed in the following manner, to-wit:

The value, at the time of actual sale in the field of all oil and/or gas or derivative products produced in, on or upon, and saved from, the lands described in and covered by said United States Government Prospecting Permits, referred to in Parcel One above, at seven and one-half (7½%) percent less than the current market price at the well for such oil [45] and/or gas or derivative products, and all oil and/or gas or derivative products, produced in, on or upon, and saved from, the lands described in and covered by said leases, referred to in Parcel Two above, at five (5%) percent less than the current market price at the well for such oil and/or gas or derivative products, LESS:

(1) Royalties paid to the Government of the United States by HONOLULU and royalties paid by HONOLULU to the original permittees or their assignees under and by virtue of said drilling agreements in respect to the drilling of the lands covered by said permits referred to in Parcel One hereof; and

(2) Royalties paid to the original lessors under and by virtue of said leases, referred to in Parcel Two hereof; and

(3) Expenses of development and operation of said properties as said terms are defined in sub-paragraphs (b), (c) and (d) of this paragraph 8.

All expenditures made or incurred by HONOLULU, as provided by sub-paragraphs (a), (b), (c) and (d) above, shall bear interest at the rate of two and one-half (2½%) percent per annum until paid, and shall be computed on the basis of average monthly increasing or decreasing balances of total net expenditures, and ELBE hereby agrees to pay such interest out of the first of the net profits payable to ELBE by HONOLULU, as above provided. Interest payable by ELBE to HONOLULU on the net expenditures made during each calendar month, shall be averaged on the 15th day of each calendar month, and shall accrue from and after forty-five (45) days after the fifteenth day of the month, in which such expenditures were made. Interest payable by ELBE to HONOLULU shall not be compounded. [46]

The term "net expenditures" as the same is used in this agreement, shall be the total expenditures for the current calendar month, less the total proceeds, if any (valued in the manner provided by Paragraph 8 hereof), resulting from the actual sale in the field of oil and/or gas or derivative products

produced in, on or upon, and saved from, said properties during said calendar month.

In the event HONOLULU shall, at any time, be permitted to suspend operations and development work upon said properties, or any part thereof, by reason of any provision in said permits or any law of the United States or rule or regulation of the proper governmental department thereof, or by reason of any provision of said drilling agreements, or by reason of any provision of said leases, then, and during such period of suspension, said expenditures, upon the properties on which operation and development shall have been suspended, shall cease to bear interest.

It is the intention of the parties to this agreement that all the reimbursement of HONOLULU shall be made from the oil and/or gas or derivative products produced in, on or upon, and saved from, the properties, the subject of this agreement, and that all interest payable by ELBE to HONOLULU, as above provided, shall be payable out of net profits resulting from the operation of said properties payable to ELBE by HONOLULU and not otherwise, and in the event the net profit resulting from the operation of the said properties payable to ELBE by HONOLULU shall not [47] be sufficient to pay the said interest payable by ELBE to HONOLULU, said interest shall accrue and become payable only at such time as the net profits payable to ELBE by HONOLULU shall be sufficient to pay the same.

9. The properties hereinabove described in Par-

agraph 1 (being Parcels One, Two, Three and Four) shall be reconveyed by HONOLULU to ELBE, and HONOLULU shall make, execute and deliver to ELBE appropriate instruments of reconveyance upon the following conditions, and not otherwise:

(a) In the event that on or before March 14, 1928, HONOLULU shall notify ELBE, in writing, of HONOLULU'S desire to abandon the purchase of said properties, then HONOLULU shall not be obligated to make any further payments to ELBE (other than the payment of Three Hundred and Fifty Thousand ($350,000.) Dollars on the execution of this agreement and approval of title, as provided by Paragraph 7 hereof) and ELBE shall have the right to the immediate possession of all of said properties, except producing wells and wells then in process of drilling, and their respective well sites, which shall include the property within a square having sides, running due north and south, and east and west, tangent to a circle, with the said well at the center, having a radius of four hundred (400) feet, together with all equipment and appurtenances necessary to operate said wells and/or [48] complete the drilling thereof. HONOLULU shall remain in possession of said producing wells and wells then in process of drilling, and their respective well sites, together with all necessary equipment and appurtenances, and

shall have the right, if it so elects, to complete and operate said wells until such time as HONOLULU shall be reimbursed in full for all expenditures made in the acquisition of said properties and in the operation and development thereof, together with interest thereon, including expenditures made from and after said March 14, 1928, in the development and operation of the wells and well sites retained by HONOLULU, in the manner above provided in respect to reimbursement of HONOLULU by paragraph 8 hereof.

HONOLULU shall have all necessary rights of way for ingress and egress, roads, water, water lines, pipe lines, and all other necessary appurtenances in the operation of the properties retained by HONOLULU, and shall have a lease and/or assignment of said producing wells and wells in process of drilling, and their respective well sites, and HONOLULU shall have the exclusive operation and control of said producing wells and wells in process of drilling, until such time as HONOLULU shall be reimbursed in full for all expenditures made by HONOLULU, and interest thereon, [49] in the manner above provided; or

(b) In the event that on or before March 14, 1929, HONOLULU shall notify ELBE, in writing, of HONOLULU'S desire to abandon the purchase of said properties, then HONOLULU shall not be obligated to make any fur-

ther payments to ELBE (other than the payment of Three Hundred and Fifty Thousand ($350,000.) Dollars on the execution of this agreement and approval of title, and the payment of Four Hundred Thousand ($400,000.) Dollars on the 14th day of March, 1928, as provided by Paragraph 7 hereof), and ELBE shall have the right to the immediate possession of all of said properties, except producing wells and wells then in process of drilling, and their respective well sites, which shall include the property within a square having sides, running due north and south, and east and west, tangent to a circle, with the said well at the center, having a radius of four hundred (400) feet, together with all equipment and appurtenances necessary to operate said wells and/or complete the drilling thereof. HONOLULU shall remain in possession of said producing wells and wells then in process of drilling, and their respective well sites, together with all necessary equipment and appurtenances, and shall have the right, if it so elects, to complete and operate said wells until [50] such time as HONOLULU shall be reimbursed in full for all expenditures made in the acquisition of said properties and in the operation and development thereof, together with interest thereon, including expenditures made from and after said March 14, 1929, in the development and operation of the wells and well sites retained by HONOLULU, in the

manner above provided in respect to reimbursement of HONOLULU by paragraph 8 hereof.

HONOLULU shall have all necessary rights of way for ingress and egress, roads, water, water lines, pipe lines, and all other necessary appurtenances in the operation of the properties retained by HONOLULU, and shall have a lease and/or assignment of said producing wells and wells in process of drilling, and their respective well sites, and HONOLULU shall have the exclusive operation and control of said producing wells and wells in process of drilling, until such time as HONOLULU shall be reimbursed in full for all expenditures made by HONOLULU, and interest thereon, in the manner above provided.

At the time or in anticipation of the reconveyance of the said properties to ELBE, as in sub-paragraphs (a) or (b) of this paragraph provided, HONOLULU shall not salvage or otherwise dispose of any equipment, appliances, tools and machinery, the cost of which shall have been computed in the [51] said expenditures, for which HONOLULU shall have been reimbursed, as hereinabove provided; and at such time as HONOLULU shall be reimbursed for all expenditures made for or in connection with said properties, as in sub-paragraphs (a) or (b) of this paragraph provided, all equipment, appliances, tools and machinery upon said properties, the cost of which shall have been computed in said expenditures, reimbursement for

which shall have been made to HONOLULU, shall become the property of and title thereto shall vest in ELBE.

On the thirtieth day of each month HONOLULU shall render to ELBE a statement for the preceding calendar month showing the gross expenditures of HONOLULU, for which HONOLULU shall have the right to reimbursement as provided by Paragraph 8, the computation of interest payable by ELBE to HONOLULU hereunder, the volume of production of oil and/or gas and/or derivative products from the said properties and the income therefrom computed in the manner provided for the valuing of oil and/or gas or derivative products, as provided by Paragraph 8 hereof. Upon demand of ELBE, HONOLULU shall render to ELBE an itemized statement of the said expenditures made by HONOLULU for which HONOLULU shall be entitled to reimbursement as provided by Paragraph 8; provided, however, that HONOLULU shall not be obligated to render to ELBE such itemized statement at intervals of less than thirty (30) days.

ELBE shall have the right to examine the books [52] of account of HONOLULU in reference to the operation and development of the properties, the subject of this agreement, at intervals of not less than thirty (30) days and shall have the right, at its sole cost and expense, to have said books of account audited, but not more often than once in any calendar year.

10. HONOLULU shall have the right to surrender at any time the whole of the properties, the subject of this agreement, or any part thereof, or any part of any single lease and/or permit and/or drilling agreement, to ELBE, or, at ELBE'S option, to the original permittee and/or lessor, and upon such surrender HONOLULU shall be released from any and all obligations in respect to the said properties so surrendered, and/or in the payment of any and all royalties resulting from the operation of the said properties so surrendered. From and after such time as HONOLULU shall notify ELBE of the surrender of the properties, the subject of this agreement, or any part thereof, or of any part of any single lease and/or permit and/or drilling agreement, in the event ELBE elects to accept such surrender itself, ELBE assumes and agrees to perform all obligations of any such property, and/or lease and/or permit and/or drilling agreement, or any part thereof, so surrendered, insofar as the performance of said obligations is necessary to protect HONOLULU in the ownership, control, possession, operation and development of the properties, the subject of this agree- [53] ment not surrendered.

11. ELBE agrees to execute any and all deeds, assignments, bills of sale and other instruments of further assurance which may be reasonably required by HONOLULU in order to accomplish the transfer and assignment to HONOLULU of all right, title and interest of ELBE in and to the properties hereinabove mentioned and described, or which may

be reasonably required by HONOLULU in order to accomplish any of the purposes of this agreement.

12. Anything in this agreement contained to the contrary notwithstanding, it is the intention of the parties to this agreement that the full ownership, possession and control of all of the properties, the subject of this agreement, and of all of the personal property acquired and/or used on and in connection with the operation and development of the properties, the subject of this agreement, shall be vested in HONOLULU, and ELBE shall have no interest in or to said properties, or in or to any personal property used on or in connection with the operation or development of the said properties, or in or to the salvage value of any thereof, except as provided by Paragraph 9.

ELBE shall have the right, by its officers or representative, to come upon any of the properties, the subject of this agreement, and examine the same and all the plants, tanks, meters and facilities used in connection with the operation and development thereof; provided, however, that [54] such examination shall be made at the sole cost and expense of ELBE and shall be made in such manner as will least interfere with the operation and development of the said properties.

The payments to be made by HONOLULU to ELBE under and by virtue of the terms hereof, shall be satisfied by deposit of such sums to account of ELBE with California National Bank of Long Beach, Long Beach, California, (or to the account of ELBE with such other bank or trust company

as ELBE may from time to time designate in writing to HONOLULU): and all notices given by HONOLULU to ELBE shall be deposited in the United States mail, postage prepaid, addressed to ELBE at 920 Roxbury Drive, Beverly Hills, California, (or at such other address as may be designated in writing by ELBE to HONOLULU). All notices given by ELBE to HONOLULU shall be deposited in the United States mail, postage prepaid, addressed to HONOLULU, at 215 Market Street, San Francisco, California, (or at such other address as HONOLULU may designate in writing to ELBE). No assignment or assignments, in whole or in part, of any sum or sums to be paid to ELBE hereunder shall entitle ELBE, or any assignee or assignees, to require HONOLULU to make payment other than to California National Bank of Long Beach, California, (or to the account of ELBE with such other bank or trust company as ELBE may from time to time designate in writing to HONOLULU), for the account of ELBE.

13. In the event that the parties to this agreement shall disagree in the interpretation of the meaning of [55] this agreement, or any clause thereof, said parties agree to submit said controversy to arbitration in the manner provided by Part Three, Title Ten of the Code of Civil Procedure of the State of California.

14. This agreement is expressly made assignable, in whole or in part, by the parties hereto.

15. This agreement shall supersede and take the place of any and all other agreements heretofore executed between the parties hereto.

IN WITNESS WHEREOF, the parties hereto have caused this agreement to be executed by their officers thereunto duly authorized, and their corporate seals to be affixed the day and year first above written.

[Seal] ELBE OIL LAND DEVELOPMENT COMPANY

By (s) C. A. WINDHAM
Vice-President

By (s) L. S. BARNES
Secretary

First Party

[Seal] HONOLULU CONSOLIDATED OIL COMPANY

By (s) A. C. DIERICX
President

By (s) ROBT. H. WRIGHT
Asst. Secretary

Second Party [56]

State of California
County of Los Angeles—ss.

On this 28th day of November in the year nineteen hundred and twenty seven, A. D. before me Frieda Segel, a Notary Public in and for the said County of Los Angeles, State of California, residing therein, duly commissioned and sworn, personally appeared C. A. WINDHAM, known to me to be the Vice-President, and L. S. BARNES, known to me to be the Secretary of ELBE OIL LAND DEVELOPMENT COMPANY, the Corporation which executed the within and annexed instrument,

and acknowledged to me that such Corporation executed the same.

IN WITNESS WHEREOF I have hereunto set my hand and affixed my official seal in said county the day and year in this certificate first above wirtten.

(s) FRIEDA SEGEL

Notary Public in and for Los Angeles County, State of California.

State of California
City and County of San Francisco—ss.

On this 29th day of November in the year One Thousand Nine Hundred and Twenty Seven, before me W. W. HEALY, a Notary Public in and for the said City and County, residing therein, duly commissioned, and sworn personally, appeared A. C. DIERICX and ROBERT H. WRIGHT, known to me to be the President and Assistant Secretary of HONOLULU CONSOLIDATED OIL COMPANY, the Corporation described in and that executed the within instrument, and also konwn to me to be the persons who executed the within instrument on behalf of the Corporation therein named, and they duly acknowledged to me that such Corporation executed the same.

IN WITNESS *WHERE,* I have hereunto set my hand and affixed my official seal, at my office in said City and County of San Francisco, the day and year in this Certificate first above written.

[Seal] (s) W. W. HEALEY,

Notary Public in and for the said City and County of San Francisco, State of California.

[Endorsed]: Filed Sept. 18, 1933. [57]

MAP
OF
ROUND MOUNTAIN
OIL FIELD
KERN COUNTY, CAL.

DEPARTMENT OF NATURAL RESOURCES
DIVISION OF OIL & GAS

T 28 S R 28 E

For adjoining Oilfield see Oil Map No. 13, Kern River

Chas. S. Young est.

J. R. Cuttletter

N. B. Smith & C. B. Shelton

Berry Holding Co.

J. Thomas

Vedder Bros. Inc. (U. S. Govt. R.R.)

A. W. Fuhrman

El Portal Mining Co.

W. A. Keating (U. S. Govt. R.R.)

Shell Oil Co.

J. Cutler

Shaw Oil Co.

E. V. McKenzie

U. S. Govt.

A. L. Hyde

Southern Pacific Land Co.

The Kern River Oilfields of California Ltd. (Mortgagee)

Julia Berkowitz

W. T. Wells

D. C. Ferguson

C. T. Wells

D. N. Norbert, Est.

J. C. Cory

T. N. Norbert

Shell Oil Company

Standard Oil Company of Calif. (Lessee)

Union Oil Co.

Petroleum Securities Co.

Associated Oil Co.

Kern River Oilfields of California

Mineral Commission of Cal.

Mineral Petroleum Operations of California

U. S. Govt.

J. A. Whitaker (U. S. Govt. R.R.)

Kern Mining (U. S. Govt. R.R.)

El Portal Mining Co.

Lizzie K. Glide

L. K. Glide

Sec. 3

Sec. 4

Sec. 5

Sec. 7

Sec. 8

Sec. 9

Sec. 10

Sec. 11

Sec. 12

Sec. 13

Sec. 14

Sec. 15

Sec. 16

Sec. 17

Sec. 18

Sec. 19

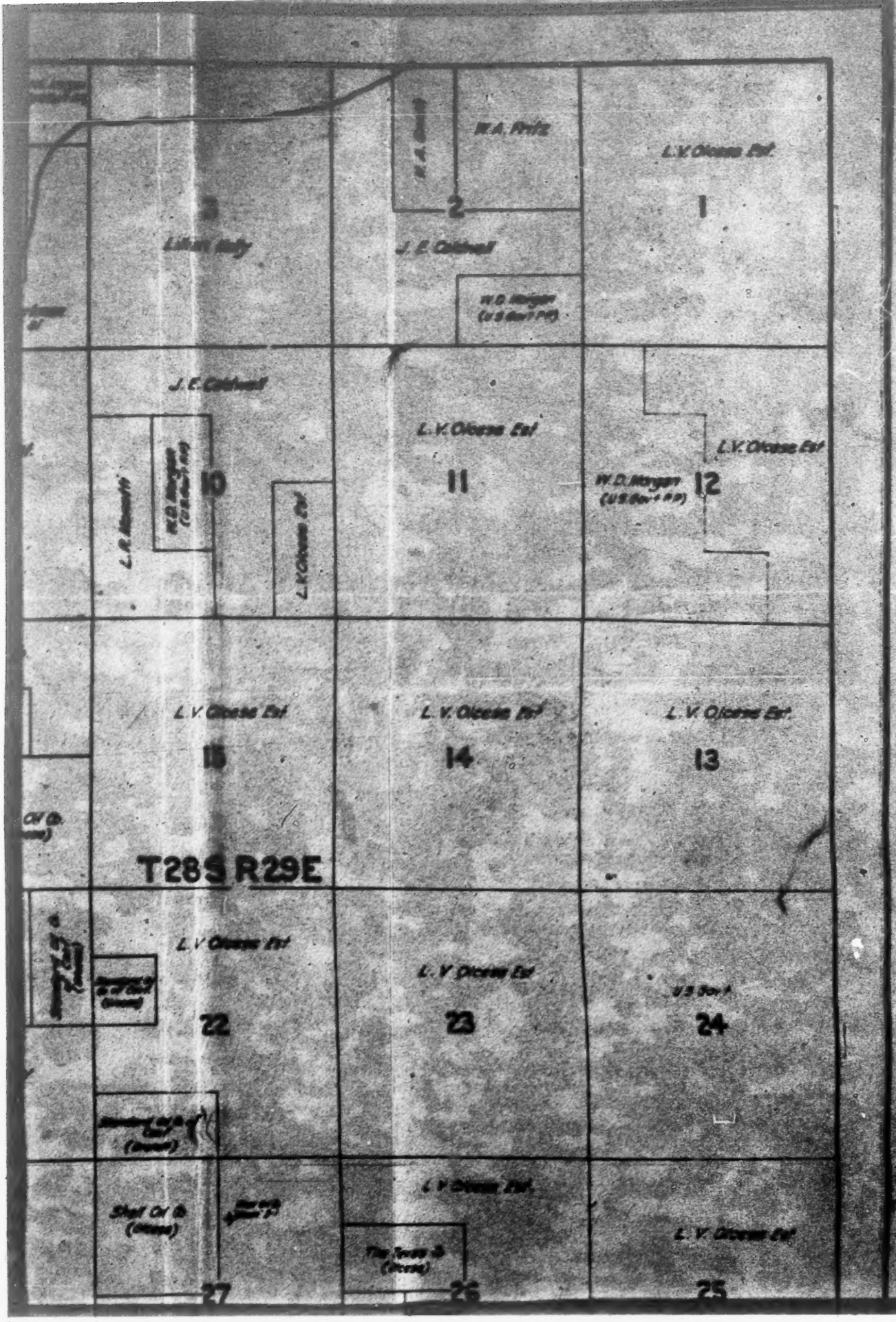
Sec. 23

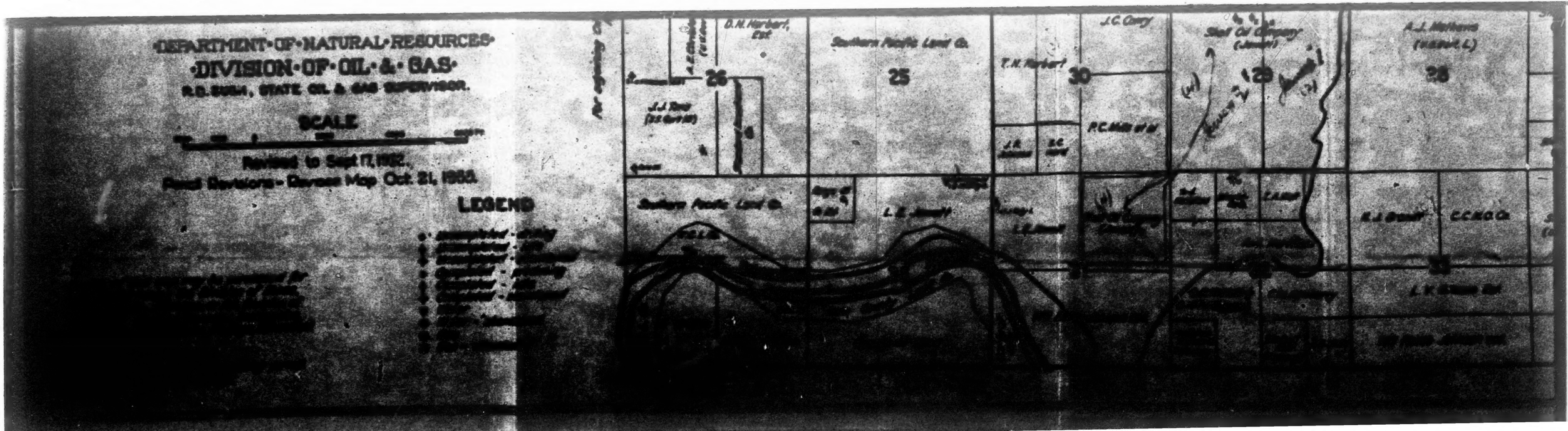
Sec. 24

L. V. Olcese Est.

C. R. & I. R. R. Co.

Kern River


W.A. Fritz
L.V. Olcese Est
1
2
J.E. Gilchrist
J.E. Gilchrist
10
L.V. Olcese Est
11
L.V. Olcese Est
12
L.V. Olcese Est
15
L.V. Olcese Est
14
L.V. Olcese Est
13
T28S R29E
L.V. Olcese Est
22
L.V. Olcese Est
23
24
L.V. Olcese Est
25
26
27


DEPARTMENT OF NATURAL RESOURCES
DIVISION OF OIL & GAS
R.D. SMITH, STATE OIL & GAS SUPERVISOR.
SCALE
Revised to Sept 17, 1952.
Field Revisions - Revised Map Oct. 21, 1953.
LEGEND
D.N. Herbert, Etal
Southern Pacific Land Co.
J.C. Carey
Shell Oil Company
A.J. Mathews
25
26
30
29
28
T.N. Herbert

[Title of Court and Cause—Docket No. 54773.]

STIPULATION.

It is hereby stipulated and agreed by and between the above-entitled parties through their respective counsel as follows:

(1) That the map attached hereto, marked exhibit "B" and made a part hereof shows the location of the leases and permits acquired by the Honolulu Consolidated Oil Company from petitioner under the terms of the transfer of October 3, 1927, said acreage being outlined in red and green;

(2) That attached hereto and marked exhibit "C" is a schedule showing the wells drilled by Honolulu Consolidated Oil Company or its assignees, the dates of spudding in, the dates of completion of said wells, and likewise shows those wells which were commercial producers and those which were abandoned.

Said map was prepared as of a date subsequent to the basic date involved herein and there are numerous wells shown thereon which were not begun or completed as of the basic date in this proceeding.

FRED R. ANGEVINE,
Counsel for Petitioner.
(Signed) E. BARRETT PRETTYMAN,
General Counsel,
Bureau of Internal Revenue. [58]

ELBE OIL LAND DEVELOPMENT COMPANY

WELL DATA ON PROPERTIES ACQUIRED BY
HONOLULU OIL CORPORATION, LTD., AND SHELL OIL COMPANY.

	Section	Well No.	Spudded in	Completed	Remarks
		HONOLULU OIL CORPORATION, LTD.			
LEASE NO. 019840:	20-28-29	1A	11/10/27	1/21/28	
	20-28-29	2	1/15/27	5/31/27	
	20-28-29	3	1/ 6/28	3/14/28	
	20-28-29	100	2/ 1/28		Abandoned 5/20/31
	20-28-29	940	2/ 9/28		Abandoned 4/17/28
	20-28-29	3A	8/18/30	10/18/30	
LEASE NO. 019847:	18-28-29	36	10/ 8/27	3/ 8/28	
LEASE NO. 019848:	18-28-29	68	10/10/27	2/22/28	
	18-28-29	99	5/ 5/30	7/31/30	
LEASE NO. 019845:	18-28-29	44	1/21/28	4/25/28	
LEASE NO. 019847:	18-28-29	14	1/23/28	5/18/28	

Comm'r of Int. Revenue

	Section	Well No.	Spudded in	Completed	Remarks
		SHELL OIL COMPANY			
JEWETT LEASE NO. 1:	29-28-29	3	6/ 6/28		Abandoned 9/12/28
	29-28-29	13	7/15/30	8/ 3/30	
JEWETT LEASE NO. 2:	29-28-29	1	12/ 8/27	1/19/28	
	29-28-29	2	2/23/28	5/13/28	
	29-28-29	4	9/19/28	11/23/28	
	29-28-29	5	2/ 5/29	3/ 7/29	
	29-28-29	6	4/29/29	5/28/29	
	29-28-29	7	8/11/29	9/24/29	
	29-28-29	8	9/13/29	10/16/29	
	29-28-29	9	1/ 6/30	2/25/30	
	29-28-29	10	11/25/29	1/ 5/30	
	29-28-29	11	3/20/30	4/17/30	
	29-28-29	12	5/20/30	6/19/30	
	29-28-29	14	9/28/30	10/29/30	
FREEMAN LEASE:	20-28-29	1	5/20/28	7/29/28	
	20-28-29	2	11/11/28	1/ 4/29	
	20-28-29	3	2/ 1/29	3/29/29	
	20-28-29	4	4/ 6/29	6/18/29	
	20-28-29	5	11/ 3/29	11/27/29	
	20-28-29	6	10/12/27		Suspended 3/8/28
	20-28-29	7	2/18/30	3/15/30	
	20-28-29	8	6/12/30	7/ 8/30	
	20-28-29	9	10/11/30	10/26/30	

[Endorsed]: Filed Jan. 30, 1934.

[Title of Court and Cause.]

Docket Nos. 54773, 60157.

Promulgated April 14, 1936.

Depletion—Oil & Gas Wells.—In 1927 petitioner under a contract of sale, conveyed its interest in certain leases, permits, drilling agreements, and all of the oil and gas produced from the properties to another corporation in consideration for cash payments to be made in the years 1927 to 1931, inclusive, totaling $2,000,000 (all of which has been paid), and in addition thereto the promise of future payments of one-third of the latter's net profits wholly contingent upon the happening of indeterminable events which had not occurred up to the year 1933. Held, that the cash payments received by petitioner in the years 1928 and 1929 constituted proceeds from the sale of a capital asset and were not gross income from the property within the meaning of that phrase as used in section 114 (b) (3) of the 1928 Act and therefore are not subject to a percentage allowance for depletion.

FRED R. ANGEVINE, Esq., W. L. E. O'BRYAN, Esq., and C. WM. WITTMAN, C. P. A., for the petitioner.

ELDEN McFARLAND, Esq., for the respondent.

OPINION.

TYSON: These consolidated proceedings seek redetermination of income tax deficiencies in the

amounts of $16,626.09 for the year 1928 and $12,-149.50 for the year 1929, asserted by respondent as the result of several adjustments made by him in the income reported by petitioner for those years. All issues, except one, have been waived or stipulated, and effect thereto will be given upon the recomputation under Rule 50. The stipulation of facts and exhibits attached thereto are included herein by reference.

The sole remaining issue, as to both years, involves the question of whether petitioner is entitled to a deduction of $110,000 for depletion at the rate of 27½ percent of a $400,000 payment received in each of those years under the terms of a written contract relative to certain oil and gas properties, executed on October 3, 1927. [61]

Petitioner, a California corporation, was organized on February 4, 1924. It acquired certain properties consisting of oil and gas prospecting permits, drilling agreements, leases, and equipment. Development work carried on by it resulted in the discovery of oil on its properties and on October 3, 1927, oil was being produced in commercial quantities.

As of October 3, 1927, under the terms of the written contract executed on that date, the petitioner sold, transferred, and conveyed all of its right, title, and interest in and to certain described prospecting permits, drilling agreements, leases, and equipment, unto the Honolulu Consolidated Oil Co., a California corporation, the latter to "have the sole ownership of and the right to sell or otherwise dispose of, all oil and/or gas and derivative products produced in,

on or upon said properties", it being "the intention of the parties to this agreement that the full and complete ownership, control and operation of said properties shall vest, upon execution hereof, in Honolulu * * * and Elbe shall have no interest in or to any of said properties whatsoever." The consideration to be paid petitioner, as set forth in paragraph 7 of said contract, was $350,000 cash upon the execution of the contract and thereafter, if the Honolulu Consolidated Oil Co. did not elect to abandon the purchase of the properties and execute reconveyances as provided by paragraph 9 of the contract, the sum of $400,000 on the 14th day of March of each of the years 1928, 1929, and 1930 and $450,000 on March 14, 1931, together with interest as specified. Of such $2,000,000 to be received by petitioner in cash and notes, the amount of $1,963,672.95 was consideration for the oil and gas rights in the leases and the remainder was consideration for equipment and other property conveyed. The stated consideration for such sale was fixed at the definite amount of $2,000,000, to be paid without reference to, and without being in any manner based upon, the production of oil from the properties conveyed.

The petitioner has received each of the payments, in the amounts and on the dates specified in the contract, totaling $2,000,000. The cost of all of the assets transferred under the contract was less than the amount of $350,000 received in 1927 and for that year petitioner reported a taxable gain, from the transaction, by applying the entire basis against the $350,000. In its returns for 1928 and 1929 peti-

tioner claimed the deduction herein sought for depletion on the ground that the payment of $400,000 received in each of those years constituted a bonus on a sublease.

The contract, in paragraph 8 thereof, provided that, "from and after the time" when the Honolulu Consolidated Oil Co. should have been fully reimbursed from its sales of oil and gas produced from [62] the properties, for all expenditures made in the acquisition, development, and operation thereof, it should pay to petitioner 33 1/3 percent of its net profits, as defined in the contract, resulting thereafter from the continued production, if any, from the properties.

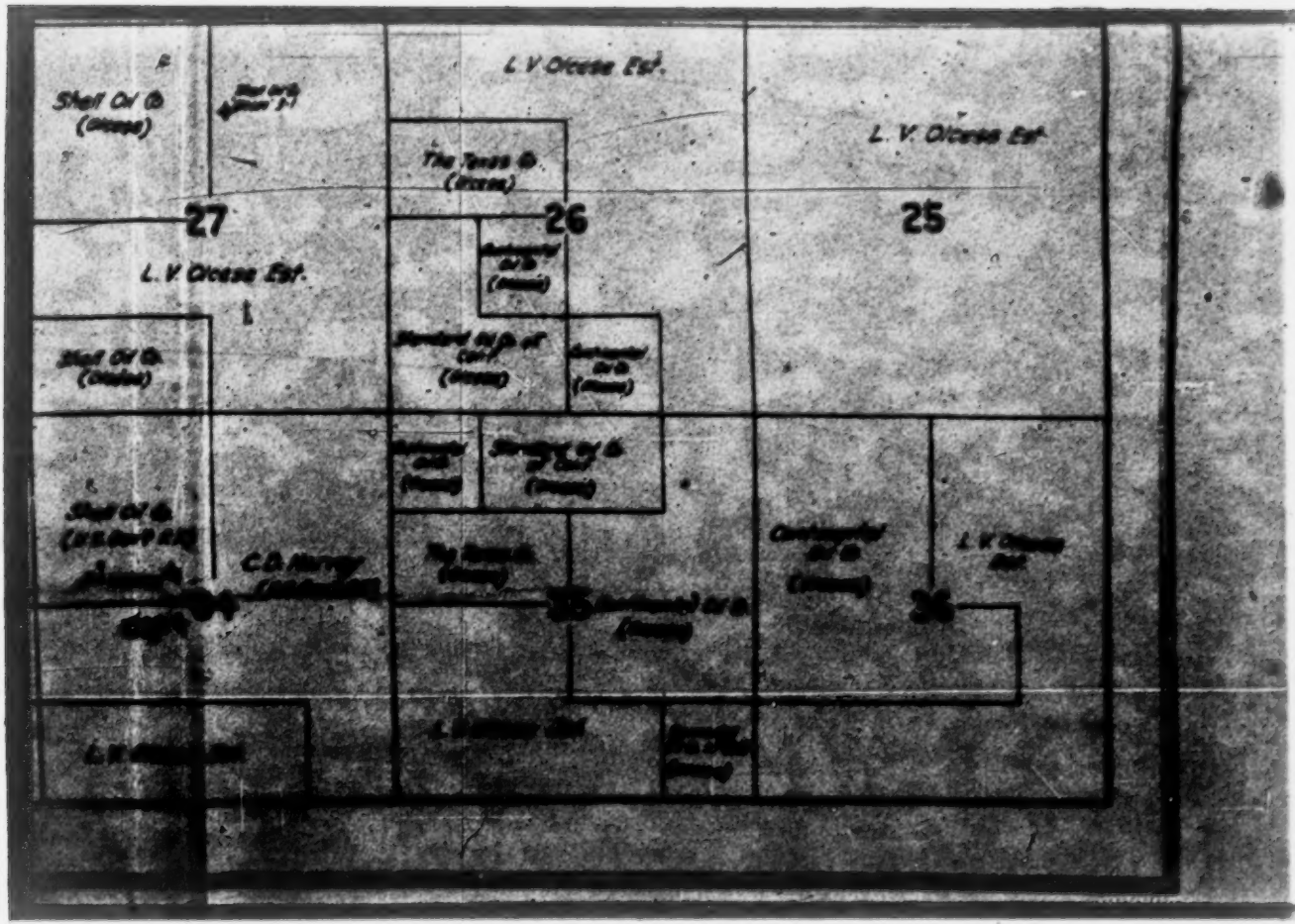
During the years here in controversy, and up to the date of hearing herein in September 1933, no payments became due or were made to petitioner by the Honolulu Consolidated Oil Co. upon the latter's wholly contingent obligation for future payments under its contract of purchase. Such contingent obligation of the Honolulu Consolidated Oil Co. is separate and apart from its obligation for the payments totaling $2,000,000 and does not impart to such payments the character of being income realized from the retention by petitioner of an economic interest in the oil and gas produced during the period covered by such payments. We do not have before us the question of the character of such future payments if and when made or whether or not they might be subject to depletion under the then applicable revenue acts.

Therefore, the only issue now before us involves the question of whether, under the provisions of section 114 (b) (3) of the Revenue Act of 1928,[1] petitioner is entitled to a deduction of 27½ percent of $400,000 for each of the years 1928 and 1929, as an "allowance for depletion * * * of the gross income from the property during the taxable year."

Petitioner contends that this proceeding is controlled by the decision in Palmer v. Bender, 287 U. S. 551. In that case the taxpayer was the member of two partnerships which in 1921 executed writings by which it "does sell, assign, set over, transfer and deliver * * * unto the Ohio Oil Co." certain leased premises in consideration of a present payment of a cash bonus, future payments to be made "out of one-half of the first oil produced and saved" to the extent of a specified sum and an additional excess royalty of one-eighth of ALL oil produced and saved. The District Court and the Circuit Court held that the transaction constituted a sale of a capital asset, that no interest was retained in the oil and gas, and that the taxpayer was not entitled to depletion. The taxpayer in the Palmer case, supra,

[1]Sec. 114 (b). BASIS FOR DEPLETION.

(3) Percentage Depletion for Oil and Gas Wells.—In the case of oil and gas wells the allowance for depletion shall be 27½ per centum of the gross income from the property during the taxable year. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance be less than it would be if computed without reference to this paragraph.


L. V. Ocean Est.
L. V. Ocean Est.
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L. V. Ocean Est.

contended that the instrument was a lease and invoked the rule in Murphy Oil Co. v. Burnet, 278 U. S. 299, that a lessor is entitled to a depletion allowance on both bonus (advance royalties) and royalties. The Supreme Court held that it was immaterial whether the [63] instrument constituted a sale, an assignment or a lease; that the question involved merely the application of section 214 (a) (10) of the Revenue Act of 1921, which provided for a deduction of a reasonable allowance for depletion "in the case of * * * oil and gas wells, * * * according to the peculiar conditions in each case"; that the language of the section did not restrict such allowance "to any particular class or to any special form of legal interest in the oil well", but is broad enough to include "every case in which the taxpayer has acquired, by investment, any interest in the oil in place, and secures, by any form of legal relationship, income derived from the extraction of the oil, to which he must look for a return of his capital", whether the taxpayer be vendor, lessor, lessee, or their transferee, so long as by the terms of the transaction involved the taxpayer retains "a right to share in the oil produced", that is, "an economic interest in the oil, in place, which is depleted by production." The Supreme Court decided that "when the two lessees (partnerships) transferred their operating rights to the two oil companies, whether they became technical sublessors or not, they retained, by their stipulations for royalties, an economic interest in the oil, in place, identical with that of a lessor", and because of this retention

of an economic interest through the medium of royalties was, to the extent of such interest, entitled to a reasonable allowance for depletion. The ground upon which the opinion in the Palmer case, supra, was based, was the retention of an economic interest by the taxpayer of the oil in place. The holding in that case then is not crontrolling in the instant case because the taxpayer herein retained no economic interest in the oil in place, so far as the payments here in controversy are concerned.

The contract of October 3, 1927, constituted an absolute sale of not only its interest in the leases, permits, and drilling agreements transferred, which might be termed operating agreements, but also ALL of the oil and gas in place, for the contract specifically provided that the Honolulu Consolidated Oil Co. acquired "the sole ownership of and the right to sell or otherwise dispose of, ALL oil and/or gas and derivative products produced in, on or upon said properties" and further that the petitioner "shall have no interest in or to any of said properties whatsoever." The consideration in the definite amount of $2,000,000 was not in any way dependent upon the production of oil from the properties. It is therefore obvious that the petitioner did not retain any economic interest or investment in the oil and gas, in place, so far as the payments here in controversy are concerned, subject to depletion on extraction, but looked only to the independent personal liability of the purchaser for the receipt of [64] the agreed purchase price of $2,000,000 pursuant to the terms of the contract of sale.

We conclude that the cash payments of $400,000 received by petitioner in each of the years 1928 and 1929 constituted proceeds from the sale of a capital asset and were not gross income from the property within the meaning of that phrase as used in section 114 (b) (3), supra, and therefore petitioner is not entitled to a depletion allowance of 27½ percent thereof under the provision of that section. William Fleming, 31 B. T. A. 623; affd.,—Fed.(2d)—(C. C. A., 5th Cir., March 11, 1931); and E. F. Simms, 28 B. T. A. 988, 1028, 1029. Cf. Comar Oil Co., 24 B. T. A. 688; affd., 64 Fed(2d) 965; certiorari denied, 290 U. S. 652. Decision will be entered under Rule 50. [65]

United States Board of Tax Appeals.
Washington, D. C.

Docket Nos. 54773, 60157.

ELBE OIL LAND DEVELOPMENT COMPANY,
Petitioner.

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION.

Pursuant to the Board's Opinion promulgated April 14, 1936, in the above entitled proceeding, the respondent having duly filed a proposed recomputation in accordance therewith, and the petitioner

having failed, after due notice, to file a counter proposed recomputation or to object, at the hearing on May 27, 1936, to the recomputation as made by respondent, it is hereby

ORDERED AND DECIDED that there is a net loss in the amount of $32,833.68 for the calendar year 1927 and that there are income tax deficiencies in the amounts of $14,327.13 and $12,149.50 for the calendar years 1928 and 1929, respectively.

[Seal] (Signed) JOHN A. TYSON,
Member.

Entered Jun. 2, 1936. [66]

[Title of Court and Cause.]

Docket Nos. 54773, 60157.

PETITION OF ELBE OIL LAND DEVELOPMENT COMPANY FOR REVIEW BY THE CIRCUIT COURT OF APPEALS OF THE UNITED STATES FOR THE NINTH CIRCUIT OF A DECISION BY THE UNITED STATES BOARD OF TAX APPEALS.

Elbe Oil Land Development Company, the petitioner in this cause, by George T. Altman, counsel, hereby files its petition for a review by the Circuit Court of Appeals of the United States for the Ninth Circuit of the decision by the United States Board of Tax Appeals rendered on June 2, 1936, 34 B. T. A. ....., No. 55, determining deficiencies in the petitioner's Federal income taxes for the years 1928 and 1929, in the respective amounts of $14,327.13 and $12,149.50, and respectfully shows:

I.

The petitioner, Elbe Oil Land Development Company, is a corporation organized and existing under and by virtue of the laws of the State of California, with its principal office in Los Angeles, California.

II.

Nature of the Controversy.

Prior to October 3, 1927 the petitioner had acquired certain properties consisting of oil and gas prospecting permits, drilling agreements, leases, and equipment. Development work carried on by it resulted in the discovery of oil on its properties and on October 3, 1927, oil was being produced in commercial quantities. On that date petitioner transferred the said [67] prospecting permits, drilling agreements, leases, and equipment, under the terms of a written contract. That contract is a part of the record made before the Board aud is incorporated by reference in the opinion of the Board. The controversy involves the legal effect of that contract with respect to the deduction for depletion, the question being whether petitioner was entitled to deduct percentage depletion at 27½ percent, under Section 114 (b) (3) of the Revenue Act of 1928, on the amounts received under that contract in 1928 and 1929. There is no other issue.

By that contract petitioner transferred the said prospecting permits, drilling agreements, leases, and equipment, to the Honolulu Consolidated Oil Company, a California corporation (hereinafter referred to as Honolulu), under the following terms:

(1) Honolulu agreed to pay to petitioner the sum of $350,000 on execution of the contract.

(2) On or before March 14, 1928, Honolulu might elect to transfer back to petitioner all of said properties (except producing wells and wells in process of drilling, which it might retain until reimbursed for all of its expenditures).

(3) If Honolulu did not so elect, then on March 14, 1928, it was required to pay petitioner the further sum of $400,000.

(4) After said payment and on or before March 14, 1929, Honolulu might again elect to transfer back to petitioner all of said properties (except, again, producing wells and wells in process of drilling, which it might retain until reimbursed for all of its expenditures).

(5) If Honolulu did not so elect then it was required to pay petitioner on March 14, 1929, the further sum of $400,000; and on March 14, 1930, the further sum of $400,000; and on March 14, 1931, the further sum of $450,000; [68] interest being added at 2½ per cent from March 14, 1929.

(6) Honolulu agreed to perform all work and labor required under the permits and leases transferred to it, and to pay the royalties required thereunder to the United States, the original permittees, and the original lessors provided, however, that Honolulu might surrender to petitioner the properties or any part thereof, and be thereupon released of the said obligation assumed with respect thereto.

(7) After Honolulu should be reimbursed for its expenditures under the contract and in operation of the properties (said reimbursement to be determined not by actual sales, but by the current market price of the oil and gas produced), then Honolulu thereafter was required to pay petitioner, monthly, one-third of the net profits from the properties.

(8) Honolulu was required to render monthly statements of operations to petitioner, with right in the petitioner to examine the books of Honolulu and to have audits made of them, and to come upon and examine the properties at any time.

The payment of $400,000 indicated above as being required to be made on March 14, 1928, was made on that date; and the payment of $400,000 indicated above as being required to be made on March 14, 1929 was made on that date. Petitioner deducted on its returns 27½ per cent, or $110,000, with respect to each of said payments received, under the provisions of Section 114 (b) (3) of the Revenue Act of 1928. The Commissioner of Internal Revenue disallowed those deductions, holding that the petitioner did not retain under the contract an economic interest in the oil, in place, which is depleted by production, so far as the payments in controversy were concerned; and the Board sustained the Commissioner. [69]

III.

The said Elbe Oil Land Development Company, being aggrieved by the conclusions and opinion of the Board, and by its decision entered pursuant

thereto, desires to obtain a review thereof by the Circuit Court of Appeals of the United States for the Ninth Circuit.

IV.

Assignments of Error.

The petitioner assigns as error the following acts and omissions of the Board of Tax Appeals:

(1) The failure to allow as a deduction the amount of $110,000 as percentage depletion for each of the years 1928 and 1929.

(2) The holding that the contract hereinbefore described constituted an outright sale of the properties covered thereby.

(3) The holding that the petitioner did not retain under said contract an interest in the oil, in place, which is depleted by production, so far as the payments received in 1928 and 1929 are concerned.

(4) The attempted separation of the said contract into two contracts, one in effect a sale (the part with reference to the stated sums to be paid) and the other in effect a sublease (the part with reference to the percentage of profits reserved), although both parts cover the same identical properties and there was but one transaction.

(5) The failure to conclude that the amounts paid to petitioner in 1928 and 1929 were in effect only bonus or minimum royalties.

(6) The failure to conclude that the contract described did not create an unconditional obligation on the part of the transferee of the properties to pay either of said amounts, but only an obliga-

tion to pay said amounts if it did not elect, on or before the dates, respectively, when payment was to [70] be made, to transfer the properties involved back to the petitioner.

(7) The failure to conclude that the contract described did not create an unconditional obligation to pay any purchase price or any amount except the initial amount paid on the execution of the contract in 1927.

(8) The determination of the nature of the contract from the surplusage of recitals of intention (omitting therefrom material restrictive clauses), instead of from the clauses indicating what the parties were actually obligated to do and entitled to do.

(9) The finding of deficiencies for the years 1928 and 1929 in lieu of a determination that there is no income tax due from the petitioner for any of the years in controversy.

(s) GEORGE T. ALTMAN
Counsel for Petitioner,
10 South LaSalle Street,
Chicago, Illinois.

State of Illinois,
County of Cook—ss:

George T. Altman, being first duly sworn, says that he is counsel of record in the above-named cause; that as such counsel he is authorized to verify the foregoing petition for review; that he has read the said petition and is familiar with the state-

ments contained therein; and that the statements made are true to the best of his knowledge, information and belief.

(s) GEORGE T. ALTMAN.

Subscribed and sworn to before me this 26th day of August, 1936.

[Seal] (s) HOMER R. HOPPS,
Notary Public.

[Endorsed]: Filed Aug. 27, 1936. [71]

[Title of Court and Cause—Docket Nos. 54773, 60157.]

PRAECIPE FOR RECORD.

To the Clerk of the United States Board of Tax Appeals:

You are hereby requested to prepare and certify and transmit to the Clerk of the United States Circuit Court of Appeals for the Ninth Circuit, with reference to petition for review heretofore filed by the petitioner in the above cause, a transcript of the record in the above cause, prepared and transmitted as required by law and by the rules of said Court, and to include in said transcript of record the following documents or certified copies thereof, to-wit:

(1) The docket entries of all proceedings before the Board of Tax Appeals.

(2) Pleadings before the Board of Tax Appeals, as follows:

(a) Petition for redetermination in Docket No. 54773.

(b) Answer of the Respondent in Docket No. 54773.

(c) Petition for redetermination in Docket No. 60157.

(d) Answer of the Respondent in Docket No. 60157.

(3) Stipulation filed by the parties on September 18, 1933, including Exhibit attached thereto.

(4) Stipulation filed by the parties on January 30, 1934, including Exhibits attached thereto.

(5) Opinion of the Board of Tax Appeals.

(6) The Decision of the Board.

(7) The Petition for review, filed by the petitioner in the above cause.

(8) This Praecipe.

Respectfully,

GEORGE T. ALTMAN

Counsel for Petitioner.

10 South LaSalle St.,

Chicago, Ill.

[Endorsed]: Filed Oct. 2, 1936. [72]

[Title of Court and Cause.—Docket Nos. 54773, 60157.]

CERTIFICATE.

I, B. D. Gamble, clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages, 1 to 72, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this 12th day of Oct., 1936.

[Seal] B. D. GAMBLE,
Clerk,
United States Board of Tax Appeals.

[Endorsed]: No. 8358. United States Circuit Court of Appeals for the Ninth Circuit. Elbe Oil Land Development Company, Petitioner, vs. Commissioner of Internal Revenue, Respondent. Transcript of the Record. Upon Petition to Review an Order of the United States Board of Tax Appeals.

Filed October 20, 1936.

PAUL P. O'BRIEN,
Clerk of the United States Circuit Court of Appeals for the Ninth Circuit.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

No. 8358

ELBE OIL LAND DEVELOPMENT COMPANY, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Upon Petition to Review a Decision of the United States Board of Tax Appeals

Excerpt from Proceedings of Tuesday, April 13, 1937

Before WILBUR, GARRECHT, and HANEY, Circuit Judges

Order of submission

Ordered above cause argued by Mr. George T. Altman, counsel for petitioner, and by Mr. Lester L. Gibson, Special Assistant to the Attorney General, counsel for respondent, and submitted to the court for consideration and decision.

Excerpt from Proceedings of Monday, June 21, 1937

Before WILBUR, DENMAN, and MATHEWS, Circuit Judges

Order directing filing of opinions and filing and recording of judgment

By direction of the court, ordered that the opinion, concurring opinion, and dissenting opinion this day rendered by this court in above cause be forthwith filed by the clerk, and that a judgment be filed and recorded in the minutes of this court in accordance with the opinion and concurring opinion.

In the United States Circuit Court of Appeals for the Ninth Circuit

No. 8358. June 21, 1937

ELBE OIL LAND DEVELOPMENT COMPANY, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Upon Petition to Review Decision of the United States Board of Tax Appeals

Before WILBUR, GARRECHT, and HANEY, Circuit Judges

WILBUR, *Circuit Judge:* In each of the taxable years 1928 and 1929 the petitioner received the sum of $400,000, being payments under an agreement with the Honolulu Consolidated Oil Company

(hereinafter called the Honolulu Company), with reference to the transfer of a large area of oil lands, the exact nature and effect of this agreement being the subject of this controversy.

The petitioner claims that it is entitled to a depletion allowance of 27½ per cent from each of these two payments by reason of the fact that it had retained an economic interest in the oil in the lands in question, while the Commissioner contends that these two items represent payments of the purchase price of the sale of the lands and, consequently, that no depletion allowance was permissible under the statute, particularly in view of the fact that a previous payment made in 1928 of $350,000 more than covered the cost of the property to the petitioner, the cost had been allowed as deduction in estimating its taxable gain derived from the payment.

The Board of Tax Appeals was largely influenced in its decision that the transaction constituted a sale by the fact that the agreement between the petitioner and the Honolulu Company expressly provided that all the right, title, and interest of the petitioner in the leases and permits upon the government land in question was conveyed to and vested in the Honolulu Company. Petitioner, however, contends that on consideration of the entire agreement, its scope and effect, it will appear that it had retained an economic interest in the oil and was therefore entitled to a depletion allowance from the cash payments received by it. The instrument under which the two payments were made may be briefly summarized as follows:

By the terms of the agreement an initial payment of $350,000 was made in 1927. This was to be followed in the years 1928 and 1929 by payments of $400,000 on the 15th day of March of each year. The Honolulu Company was to take possession of the property and drill for oil, as required by the various leases and permits which were assigned to it by the petitioner. It reserved the right, however, to surrender the property without making the payment of 1928, or, after that payment, before making the payment of 1929, if it so desired. However, in the event of such surrender or reconveyance as it is styled in the instrument in question, the Honolulu Company retained the right to the possession of all oil wells which had been completed or were in the process of drilling until such time as it had been reimbursed for all its expenditures and all payments it had made to the petitioner. If the Honolulu Company did not surrender the property before the 14th of March 1929, it agreed to continue payments aggregating in all $2,000,000. After its payments were completed no further sums were to be paid to the petitioner until the Honolulu Company had been reimbursed for all payments and expenditures it had incurred in connection with the property, including the $2,000,000 paid, and thereafter the petitioner was to receive one-third of all oil produced. It is difficult to distinguish the situation thus presented from the case of an ordinary lease providing for bonus payments and royalties so frequently dealt with

in the decisions involving the right to a depletion allowance for income tax purposes.

It is apparent that the whole contract was based upon the value of the oil content of the land. The payments made to the petitioner in 1928–1929 were optional with the Honolulu Company which, prior to that time, was in possession of the property and developing its oil resources. In the event the land proved valueless there was no obligation on the part of the Honolulu Company to pay $400,000. If payment was made it is clear that it was only because of the belief that development of the oil resources of the land justified such payment. Here it should be added that the agreement in question provided that the Honolulu Company could surrender any of the leases or leased land covered by the contract after notice to the petitioner and without incurring any liability because of such surrender.

The decision of the Supreme Court in Palmer v. Bender, 287 U. S. 551, dealt with a somewhat similar situation. There the owner of certain oil leases transferred the leased property in consideration of a cash bonus and the future payment to be made out of the oil produced to the extent of $1,000,000, plus a royalty of one-eighth of all the oil produced and saved. The instrument purported to be a sale. The Commissioner refused to permit a depletion allowance to the seller, upon the theory that the transaction was a sale and that the purchaser must take his capital return by deduction of the cost from the sale price. The contention was made that under the law of Louisiana the so-called sale was in legal effect an assignment or sublease. The court, however, took the broad view that this was entirely immaterial. The question of whether or not depletion allowance should be given was to be determined by the Revenue Act. We quote from the opinion in that regard as follows:

"Nothing in Sec. 214 (a) (10) [concerning depletion allowance] indicates that its application is to be controlled or varied by any particular characterization by local law of the interests to which it is to be applied. See Burnet v. Harmel, ante, p. 103 (287 U. S.). We look to the statute itself and to the decisions construing it to ascertain to what interests it is to be applied and then to the particular interests secured to the two partnerships [who had transferred their oil leases] by the instruments in question to ascertain whether they come within the statutory provision. The formal attributes of those instruments or the descriptive terminology which may be applied to them in the local law are both irrelevant. * * *

"Similarly, the lessor's right to a depletion allowance does not depend upon his retention of ownership or any other particular form of legal interest in the mineral content of the land. It is enough if, by virtue of the leasing transaction, he has retained a right to share in the oil produced. If so, he has an economic interest in the oil, in place, which is depleted by production. * * *

"When the two lessees transferred their operating rights to the two oil companies, whether they became technical sub-lessors or not, they retained, by their stipulations for royalties, an economic in-

terest in the oil, in place, identical with that of a lessor. * * * The loss or destruction of the oil at any time from the date of the leases until complete extraction would have resulted in loss to the partnerships. Such an interest is, we think, included within the meaning and purpose of the statute permitting deduction in the case of oil and gas wells of a reasonable allowance for depletion according to the peculiar conditions in each case."

The respondent strongly relies upon our decision in Elliott Petroleum Corp. v. Comm'r, 82 F. (2) 193, decided March 9, 1936, and upon a decision of the Circuit Court of Appeals for the Fifth Circuit, Fleming v. Comm'r, 82 F. (2d) 324, decided March 7, 1936.

In the case before us (Elliott Petroleum Corp. v. Comm'r, supra) the question at issue was whether or not in the sale of an oil lease for cash and for a fixed balance payable out of the net proceeds of oil production from the lease sold, the taxpayer (vendor) was entitled to a depletion allowance upon the payments to it derived from the oil produced from the land where it had already been permitted to deduct the entire cost for the land from the cash payment theretofore made in estimating the taxable income. We sustained the holding of the Board of Tax Appeals that the vendor had an economic interest in the oil in place which entitled it to a share in the depletion allowance. We expressly refrained from passing upon the question of whether or not the Commissioner had properly allowed the entire cost of the property as a deduction from the cash payment in estimating the taxable income therefrom, deciding only that so far as the payments derived from the oil were concerned there was a right of depletion where the payment was contingent upon the recovery of sufficient oil to pay the amount due. We thus reserved the very question which is involved in the case at bar, namely, the amount and character of the deduction allowable from the cash payments in such a transaction.

In Fleming v. Comm'r, supra, a similar question was presented. The cash payment was $1,000,000, and a second million was to be paid from the proceeds of the oil derived from the premises. It was held by a majority of the court that the seller of the land was not entitled to a depletion deduction from the $1,000,000 in cash which he had received, but that he was entitled to a deduction from the payments derived from "one-fourth of all the oil, gas, and other minerals produced", etc. Circuit Judge Foster dissented upon the ground that under the decision of the Supreme Court in Palmer v. Bender, supra, there should also be a deduction for depletion on cash payment "since the taxpayer retains an economic interest in the oil in place." The opinion of the majority in that case called attention to the fact that in Texas "oil and gas in the ground are capable of ownership and sale separate from the soil which contains them, and leases such as are here involved convey to the lessee title to the oil and gas." The court said:

"While the contract was phrased as though the lease and all the oil were sold, and as though the proceeds were to be paid back to the

seller, the real essence of the transaction was that the lease was sold and all the oil except that whose proceeds were to come to the selling taxpayer. * * * The thing sold for the cash consideration was the lease and all the oil except that so reserved." Under the law of Texas, as the court states, oil in place can be sold. While the court expressly declared that the law of Texas was not controlling, the idea of a sale of the land and three-fourths of the oil content, and a reservation of one-fourth of the oil content (up to $1,000,000) was the determining factor in the decision that the $1,000,000 paid outright as consideration for the sale was to have no depletion allowance, only a deduction for cost, and that the money payable only from the oil produced should have a depletion allowance of 27½%.

If the case at bar cannot be distinguished from the decision of the Fifth Circuit Court of Appeals in Comm'r. v. Fleming, supra, because of the fact that the two $400,000 payments involved here were to be optional with the purchaser, and thus were obviously dependent upon the result of exploratory operations for oil, and because of the fact that the vendee had the right to surrender the premises at any time before the payment of the second $400,000, as the Commissioner contends it can be distinguished, we must then decline to follow that decision. In the case at bar it is entirely clear that no matter what language we use in describing the nature of the transaction between the petitioner and the Honolulu Company, the petitioner had at all times an economic interest in the oil produced from the leased premises and was therefore entitled to a depletion allowance upon the cash paid as well as the oil produced. It was in effect a guarantee of future oil production and made because of such anticipated production, and upon an express agreement that the Honolulu Company was to be reimbursed therefrom before the taxpayer received its royalty payments. It was entitled to a depletion allowance under the Revenue Act of 1928, Sec. 114 (d) (3). (Herring v. Comm'r, 293 U. S. 322).

Reversed.

HANEY, Circuit Judge, Concurring.

I concur in the holding that depletion deduction must be here allowed, solely on the ground that although Palmer v. Bender, 287 U. S. 551 is distinguishable on its facts, the language used therein is general enough to embrace the facts herein.

GARRECHT, Circuit Judge, dissenting:

The majority of the court in reversing the order of the Board of Tax Appeals rely upon the decision of the Supreme Court in Palmer v. Bender, 287 U. S. 551.

In that case the taxpayer very definitely had an economic interest in the oil and taxes were assessed on payments made from oil produced, but here the payments taxed were made in cash and were not dependent upon the production of oil.

The gross income from the property which is subject to the depletion allowance is the gross income from the oil and gas produced. Helvering v. Twin Bell Syndicate, 293 U. S. 312. Here the payments subjected to the tax did not depend upon production but were pay-

able in any event. Commissioner of Internal Revenue v. Fleming, 82 F. (2d) 324.

The order of the Board of Tax Appeals should be sustained.

(Endorsed:) Opinion, Concurring and Dissenting Opinion. Filed June 21, 1937. Paul P. O'Brien, Clerk.

United States Circuit Court of Appeals for the Ninth Circuit

No. 8358

ELBE OIL LAND DEVELOPMENT CO., PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Upon Petition to Review a Decision of the United States Board of Tax Appeals

Judgment

This Cause came on to be heard on the Transcript of the Record from the United States Board of Tax Appeals and was duly submitted.

On Consideration Whereof, it is now here ordered and adjudged by this Court, that the Decision of the said Board of Tax Appeals in this Cause be, and hereby is reversed.

(Endorsed:) Judgment. Filed and entered June 21, 1937. Paul P. O'Brien, Clerk.

Certificate of Clerk, U. S. Circuit Court of Appeals for the Ninth Circuit, to record certified under Rule 38 of the Revised Rules of the Supreme Court of the United States

I, Paul P. O'Brien, as Clerk of the United States Circuit Court of Appeals for the Ninth Circuit, do hereby certify the foregoing ninety-five (95) pages, numbered from and including 1 to and including 95, to be a full, true, and correct copy of the entire record of the above-entitled case in the said Circuit Court of Appeals, made pursuant to request of Hon. Stanley Reed, Solicitor General of the United States, of counsel for the respondent, and certified under Rule 38 of the Revised Rules of the Supreme Court of the United States, as the originals thereof remain on file and appear of record in my office.

Attest my hand and the seal of the said the United States Circuit Court of Appeals for the Ninth Circuit, at the City of San Francisco, in the State of California, this 10th day of September, A. D. 1937.

[SEAL]

PAUL P. O'BRIEN, *Clerk.*
By FRANK H. SCHMID, *Deputy Clerk.*

U. S. GOVERNMENT PRINTING OFFICE: 1937

Supreme Court of the United States

Order allowing certiorari

Filed November 8, 1937

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Ninth Circuit is granted, and the case is assigned for hearing immediately following No. 406.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

U. S. GOVERNMENT PRINTING OFFICE: 1937